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Regulation

Nov/Dec 1979 AEI Journal on Government and Society

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LOUIS LASAGNA

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Regulation

Nov/Dec 1979 AEI Journal on Government and Society

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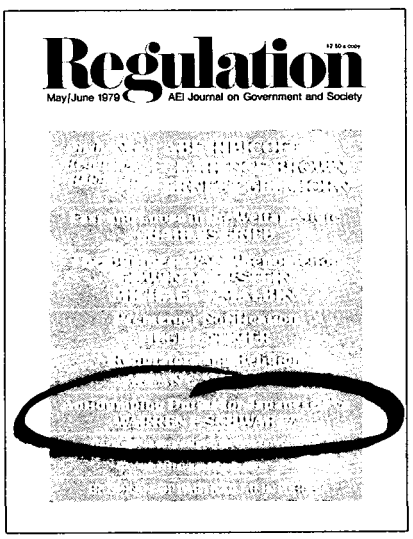
Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.



Antidumping

TO THE EDITOR:

In your May/June issue, Warren F. Schwartz ("Antidumping Duties for Japanese TVs") bitterly denounced the antidumping act in general and that statute's application to Japanese television sets in particular. He concluded his article with a challenge: "It would seem reasonable . . . to ask those holding a contrary view to demonstrate not only that there is in principle something to be said for the law, but also that its objectives can be secured at a cost that makes their attainment worthwhile."

I accept that challenge.

The article is grounded upon the proposition that discriminatory pricing (that is, dumping) is good for the economy. Says Professor Schwartz: "The question why a duty should be imposed and consumers denied an opportunity to purchase goods at prices freely offered by foreign suppliers has not been addressed by Congress in a long, long time. I believe, moreover, that it is a question with no good answer. The law . . . appears to have been passed in response to perceived evils that would now be regarded by many scholars as nonexistent. . . ."

Scholars perhaps. But certainly not anyone who has to deal with the real world.

In the real world, American producers are forced to compete for the U.S. market against foreign companies which are not only exempt from the antitrust laws but are not bound by the disciplines of a free market economy. Japanese firms, for example, need not worry about *attracting* equity capital in most circumstances; because of the semi-socialized structure of their industrial sector, they can borrow what they need despite 80–20 debt-equity ratios. The Japanese government encourages rationalization of production (which is, by definition, anticompetitive) to ensure maximum output and employment. In turn, that government virtually guarantees the continuing existence of firms that would have long since been bankrupt in a free market.

The situation is roughly the same in almost every industrial country in the world. British Steel Corporation, for example, loses over $2 million *every day* but continues to sell its products in the United States at a fraction of their price in the United Kingdom. No matter how efficient, productive, or skillfully managed an American company might be, it simply cannot compete successfully against firms whose losses are underwritten by foreign taxpayers—or foreign consumers.

This is the premise of the antidumping act. In most countries, home markets are protected by a plethora of tariff and nontariff barriers which effectively deny entry of import competition (just *try* to sell a Pinto in Tokyo: price $17,000+). Foreign consumers (or taxpayers) are gouged to enable otherwise noncompetitive products to be sold at cut-rate prices abroad. Why? Because most of our trading partners place production (*not* productivity) above profits in the scale of importance. *Jobs,* even make-work jobs, are a political objective. Further, many countries like Japan are almost totally dependent upon exports to maintain their economies.

Well now, says Professor Schwartz, perhaps all that is true. Why shouldn't American consumers benefit if foreign taxpayers want to underwrite low inflation in this country? The reason is that consumers are also taxpayers, and jobholders. Only some of them aren't holding jobs anymore.

Rather than agonize over the costs of enforcing the antidumping act, Schwartz should view the costs of *not* enforcing the act. Last year, $7 million was spent in administering this law. In the same period, $277 million was spent in federal funds to aid workers who lost their jobs owing to unfair import competition, and millions more for unemployment compensation for their workers. In addition, billions in tax revenues were lost because American companies folded their tents in response to rapacious foreign pricing policies.

All right, already, intones Professor Schwartz (following the dictates of the Lewis Carroll School of Economics), but *consumers* still have saved money as consumers, even if they had to pay back their savings in increased taxes. And besides, "import penetration [of television sets] has been far too minor to pose a significant threat to the viability of the domestic TV industry."

I am rarely at a loss for words, but this statement leaves me almost speechless. Let's look at the facts. Last year, imports captured over 85 percent of the American market for black and white television and over 25 percent of the color television market. And these figures do *not* reflect the fact that most of the so-called "American-made" television sets are primarily fabricated abroad. One simply cannot buy a totally American-made television set today.

In sum, Schwartz is wrong in his facts and wrong in his judgment of public policy. More important, he does not understand the costs—including the social anguish—that results from corporate bankruptcy or

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plant closings. He does not realize that low-priced Japanese TVs are purchased at the cost of ruin to families in Albion, Michigan, or Horseheads, New York, or Sioux City, Iowa. The window in his ivory tower is a very narrow one, indeed.

Donald E. deKieffer,
Attorney at Law,
Washington, D.C.

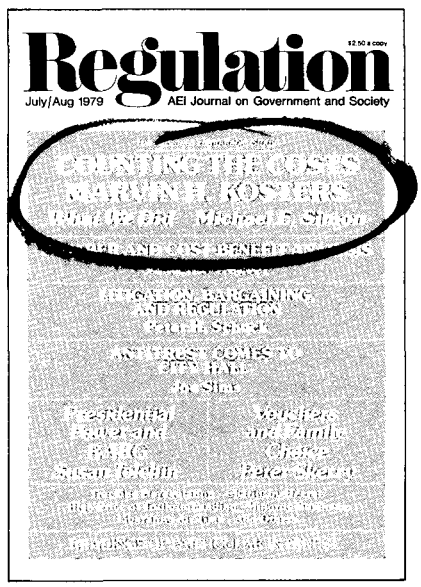
WARREN SCHWARTZ responds:

Mr. deKieffer's letter illustrates the principal point of my article. The letter contains a litany of complaints about foreign regulation and support of firms engaging in export sales to the United States. These include inadequacies in foreign antitrust laws, government debt financing of export firms, government support of industrial "rationalization," government subsidization of firms that would otherwise go into bankruptcy, and protection of the home industry against U.S. exports.

In addition, deKieffer refers to the decrease in the share of the American TV market supplied domestically and the associated reduction in the number of plants and employees engaged in TV production. He does not, however, specify the casual relationship between the various activities of the foreign governments and firms and the increase in imports.

It's clear that his objections to the behavior of foreign governments and firms (whatever their factual accuracy or justification on policy grounds may be) did not form the basis for the passage of the antidumping laws. It would seem, moreover, that if these objections are accepted, far more direct and drastic measures would be required to provide the relief to which U.S. firms and labor unions are entitled. The antidumping laws surely constitute a costly and inadequate response to the posited evils.

It is true that I personally believe there is considerable reason to doubt whether more fundamental economic forces are not really at work rather than the diabolical efforts of foreign countries to increase exports (deKieffer does not specify to what level) to which Mr. deKieffer attributes the increase in imports. He does note that U.S. firms are importing more and more component parts. And this does suggest lower costs of manufacture abroad—the classic reason for the occurrence of international trade. But it may be, of course, that both things are happening. Perhaps there is something "bad" about the way foreign governments, through action and inaction, are encouraging exports and the way foreign firms are responding to the incentives offered. What I called for is a precise specification of what it is that is undesirable about the activity of the foreign government and firms and how enforcement of the antidumping laws improves the situation, taking into account the costs of enforcement. (By costs, I of course mean social costs, not just direct administrative costs as deKieffer construes my remarks.) At most deKieffer's reply indicates that much is wrong in the way foreign rivals behave and therefore any program which leads to reduced imports must be desirable. I would simply ask the proponents of the antidumping laws to specify their grievances and spell out the ways in which the antidumping laws and the alternative forms of U.S. government action respond to them.



Costs and Benefits

TO THE EDITOR:

As both Marvin Kosters and Michael Simon correctly point out in their articles on the Business Roundtable study ["Counting the Costs" and "What We Did," respectively, *Regulation*, July/August], affixing accurate price tags to the cost of government regulations is extremely difficult. Measuring the benefits of regulations is even tougher—and at least as important. At the Environmental Protection Agency we have to weigh both costs and benefits for all our regulatory programs.

The Business Roundtable's "Cost of Government Regulation Study" is a commendable attempt to quantify some of the costs. The study's strength rests on the use of a consistent methodology, based on the concept of incremental costs, which is applied across six regulatory programs and forty-eight companies. The result is a rigorous and professional analysis.

Both Kosters and Simon acknowledge, however, that the study is necessarily limited. Ignoring both indirect costs and the overall benefits of regulation, it counts only direct compliance costs. Substantial judgment is required to pin down even those more easily measured costs.

These unavoidable limitations, together with some methodological faults, yield a misleading finding. The study tags EPA with responsibility for more than three-quarters of the total costs for the six regulatory programs. Costs that the study ignores, like those stemming from price regulation and restrictions on competition, are probably lower for the Environmental Protection Agency than for other regulatory programs. In addition during 1977, the year of the study, companies experienced unusually large pollution control expenditures because they were making long-term investments required by the clean air and water acts. Yet the study fails to spread these costs out over the useful life of the investments. The net result of these weaknesses is to exaggerate EPA's share of the regulatory burden.

At EPA we always take a careful look at those costs when we regulate and then we actively work to reduce the burden of our regulations—without sacrificing our commitment to a cleaner environment. We have found that we can improve our regulations by assessing their economic impact, evaluating alternatives, and promoting public participation.

Most important, EPA is designing new regulatory programs that reduce pollution control costs, encourage technological innovation, and maximize opportunities for economic growth. As an alternative to "command and control" regulatory approaches that have been criticized as inflexible and inefficient, we are exploring reforms that rely on economic incentives to channel private behavior in environmentally sound ways. For example, one re-

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form, the bubble concept, gives the plant manager discretion to choose how much to control each individual process, provided the plant stays within an overall emission limit.

We are constantly exploring the potential for regulatory reforms and we appreciate the constructive input that studies such as the Business Roundtable study provide to regulatory decisions.

Douglas Costle, Administrator, Environmental Protection Agency

TO THE EDITOR:

As chief financial officer of one of the forty-eight companies that participated in the Business Roundtable's study of regulatory costs, I read with special interest the Kosters and Simon articles.

General Electric shares Marvin Kosters's view that the goals of many federal regulatory programs are desirable. We also believe the private sector must supply credible leadership in its arguments against unnecessary or untimely regulations —no easy task given the monumental complexity of analyzing the direct and indirect costs of such government intervention.

Kosters indicates that a "considerable amount of judgment" was required to determine what companies might have done in the absence of regulation. In our experience, this was not so. For the large majority of projects, once they were identified, it required less judgment than one would have expected to determine to what extent they would have been undertaken in the absence of regulations. For the few projects in the gray area, we leaned deliberately toward exclusion of doubtful items.

In addition, Kosters raises the question of the treatment of expenditures for capital equipment. It is certainly correct that the incremental costs disclosed by the study were not prepared in the conventional accounting sense but reflect the timing of disbursements rather than the timing of their depreciation for tax purpose. This approach does reflect, however, an accurate picture of resource allocation, which we feel provides a meaningful measure of the incremental impact of federal regulations.

Without question, the study would have been much more valuable if it had also included representatives of medium- and smaller-size companies. As Michael Simon rightly points out, for example, it was this imbalance in the size of the participants that made it impossible to extrapolate the study's results to the economy as a whole.

Interested readers who share our conviction about the utility of broader participation may well want to pursue this natural follow-on to the initial Roundtable effort. Such participation would not only serve the interest of the private sector as a whole, but would provide an important payoff to all smaller firms whose operations, we intuitively suspect, are probably affected relatively more by federal regulation than those of larger companies—for the latter are likely to be better equipped to handle the regulatory flood.

A. O. Way, Senior Vice President, Finance, General Electric Company

TO THE EDITOR:

. . . As Marvin Kosters points out, the utility of the Business Roundtable's study is limited by its narrow focus on the incremental costs of regulation (as reflected in firms' business records). Important categories in the regulatory cost calculus are overlooked and the question of offsetting benefits is ignored entirely.

In fairness the study's author, Arthur Andersen and Co., makes very modest claims about the importance of its contribution to the science of regulatory cost measurement. (See Michael Simon's discussion, "What We Did," in the same issue.) However, Kosters's critique demonstrates plainly that we need to know much more about regulatory costs and benefits than the Andersen methodology can tell us.

Categorizing regulatory costs is a tricky business. Kosters explains his own cost taxonomy with the clarity and brevity of a first-class teacher, providing a critical perspective on other measurement methodologies and sharpening our thinking on the measurement problem in general. It should be noted, however, that Kosters's own approach also fails to comprehend important aspects of the overall effect of regulation—that is, regulatory impacts apart from costs. Examples of such impacts include shifts in income distribution, changes in outputs, increases or decreases in productivity, and changes in the geographic distribution of economic activity. Empirically speaking, we have hardly begun to

(Continues on page 59)

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Perspectives
on current developments

Antitrust Rulemaking at the FTC

On October 18, the comment period closed on the petition pending before the Federal Trade Commission for issuance of a rule banning oil company ownership of certain classes of petroleum pipelines. The commission's staff will consider the comments and then recommend "appropriate action"—including, presumably, whether to commence a rulemaking proceeding. Yet prominently missing from the specific questions set forth in the commission's request for comment was the central issue the proceeding presents—an issue with implications far beyond a ban on vertical integration in the oil industry. By entertaining the proceeding, the FTC is threatening to use a power never before significantly exercised—and, until the 1960s, never before claimed: the power to promulgate legally binding rules in the antitrust field.

The basic powers and authorities of the commission, with respect to both its original antitrust responsibilities and its subsequently added consumer protection responsibilities, were set forth in the Federal Trade Commission Act of 1914. For a half century, the exclusive means by which the commission established legally binding prescriptions under the act in both fields was the conduct of adjudicatory, trial-type proceedings against individual companies. The commission did not assert any substantive rulemaking authority—and there were indeed some official disclaimers of such authority.

In 1962, however, the commission adopted procedures for "trade regulation rulemaking" and, within a few years, began to issue substantive rules in the consumer protection field. Its authority to do so was brought to a court test in the *National Petroleum Refiners* case, involving a rule that required gas stations to post gasoline octane ratings. The U.S. District Court for the District of Columbia held the rule invalid in 1972, but the next year the court of appeals reversed, finding in Section 6(g) of the Federal Trade Commission Act the necessary rulemaking authority. The Supreme Court declined to accept discretionary review.

While *National Petroleum Refiners* was making its way through the courts, there was significant activity on the legislative front. In 1971, the commission supported a bill that would specifically confirm rulemaking authority in the consumer protection (but not the antitrust) field. Needless to say, the FTC's ardor for the bill (which soon acquired some restrictive features—notably, the addition of trial-type procedures to the simple rulemaking process permitted by the Administrative Procedure Act) cooled considerably, once its long dormant 1914 authority had been confirmed by the courts. By the same token, however, the zeal of many who had opposed the bill likewise cooled—or, rather, reversed direction, since they now found the restrictive features essential. The ultimate result was the Magnuson-Moss Act, passed in 1975, which established what might be termed a quasi-adjudicative procedure for consumer protection rulemaking. It did not delete (as some of the legislative proposals put forward at the time would have done) the language in the 1914 statute that assertedly authorized substantive antitrust rulemaking. Instead, it provided (quite ambiguously) that the new rulemaking provisions it contained "shall not affect any authority of the Commission to prescribe rules . . . with respect to unfair methods of competition." In other words, Magnuson-Moss left the antitrust rulemaking issue to be fought out in the courts on the basis of the 1914 legislation.

If the Magnuson-Moss Act were not in the picture, the chances of the Supreme Court's invalidating FTC antitrust rulemaking authority would seem slim indeed. Though the *National Petroleum Refiners* decision pertained to a consumer protection rule, the court of

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appeals' reasoning, and the statutory provisions upon which it relied, apply with equal force to antitrust rulemaking; and the Supreme Court's denial of discretionary review, while technically not of any precedential effect, would, in a case of such importance, normally connote agreement with the court of appeals. It would be disruptive to strike down at this late date an important authority which the Supreme Court was unwilling to stay six years ago and which has been the basis of much agency action since then.

But the point is that Magnuson-Moss has wiped the slate clean. Because of the consumer protection rulemaking authority conferred by that legislation, the Supreme Court can now agree with the district court's view in *National Petroleum Refiners* without destroying the commission's consumer protection rulemaking authority, and without even upsetting any individual rulemaking commenced after 1975. Or to put the matter another way, by reason of Magnuson-Moss the Court can now be selective in its invalidation of rulemaking authority, striking it down as to antitrust rulemaking (under the 1914 act) while leaving it intact as to consumer protection rulemaking (under Magnuson-Moss).

That leaves, of course, the question whether the Court *should* reach such a result. Perhaps so. Insofar as pure interpretation of the 1914 act is concerned—confirmed by half a century of practice—the district court opinion in *National Petroleum Refiners* has much the better of the argument. But with respect to consumer protection activities, one can at least plausibly argue that the failure of Congress to advert specifically to substantive rulemaking authority in an era that knew very little of that device should not be interpreted to deprive a modern agency of what has become a standard and (many believe) indispensable means of regulatory prescription. That pragmatic argument has less force with respect to antitrust rulemaking, for several reasons. First, antitrust enforcement authority has been conferred not only upon the trade commission, but also upon the Justice Department, through the authority to bring injunction actions and criminal prosecutions. Such an arrangement, together with the provision for private, treble-damage suits, assumes (what has always been the case) a greater degree of control *by the courts* than is compatible with the existence of substantive rulemaking authority. In other words, the "discovery" of a latent antitrust rulemaking authority would not only accord the FTC a technique already possessed by all major regulatory agencies. It would also drastically alter the division of substantive responsibility between that agency and the Justice Department, and between the executive branch and the courts. Another factor weakening the pragmatic case for antitrust rulemaking authority is a belief on the part of many experts (including, in the past, at least one chairman of the FTC) that the economically disruptive device of antitrust proscription does not lend itself to wholesale use, but requires a consideration of particularized circumstances and a flexibility which only case-by-case application can provide. Finally (and closely related to both of the previous points) there is the fact that the authority to govern pricing practices, and indeed to restructure industries, involves a massive degree of power over the economy, and therefore may demand a more explicit legislative expression of authority to act by rule than would suffice for the prescription of trade practices.

Thus it may well be that the Supreme Court would strike down any rule adopted as a consequence of the present proceeding. But the matter is not likely to get that far. Apart from a monumentally unimportant rule on advertising and promotional allowances in the men's and boy's tailored clothing industry (adopted in 1967 with the general support of the industry), the commission has rattled the antitrust rulemaking sabre once before, in a 1966 hearing looking toward rules governing vertical mergers in the cement industry. The world never learned whether there was anything but a sabre-handle in the scabbard, since the hearing produced no action. The same result seems likely in the present case. Six years ago, when the Magnuson-Moss proposals were under consideration, Chairman Engman assured Congress that he would not contemplate using rulemaking powers in the antitrust field. From a political standpoint, the commission chose a good target for departing from that assurance (the oil industry); but, as matters turned out, its timing could not have been worse. Even as the assertion of rulemaking authority in the antitrust field is being contemplated, Chairman Pertschuk is fighting a life-

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and-death struggle on Capitol Hill to retain those rulemaking powers explicitly conferred by Magnuson-Moss. A proposal to subject all such rulemaking to legislative veto seems likely to pass, and there is substantial support for proposals excluding all rulemaking for particular industries (to wit, most of those industries in which the commission has held rulemaking hearings). It hardly seems a propitious time for new adventures at the FTC.

On the other hand, the oil industry is currently in no better odor than the commission, and there have been at least a few occasions in the past when Congress has not permitted popular measures to be deterred by generalized considerations of principle as incomprehensible to the general public as the FTC's antitrust rulemaking authority. And there is another factor whose impact upon the FTC and the Congress may be of increasing importance in the coming months and (perhaps) years: the petition that is the subject of the current comments was filed by Senator Edward M. Kennedy.

Reforming International Airline Regulation

With the battle for domestic airline deregulation now largely over, the Civil Aeronautics Board and the still reform-minded aviation subcommittees in Congress have, in apparently unrelated actions, turned their attention to the international arena. Both are moving in the direction of more competition in international aviation—Congress through legislation and the CAB in a Show Cause proceeding that affects the future of the International Air Transport Association (IATA). Their decisions may also have an impact on other U.S. policies, determining how a nation that is moving fast to place more reliance on the market can get along in a world still committed to government regulation.

On the legislative side, the Senate and House of Representatives recently passed their respective versions of the proposed International Air Transportation Competition Act of 1979. Despite important differences between the two bills, it is clear that the result will provide a push toward free trade in international aviation. U.S. carriers, for instance, would for the first time be allowed to "wet lease" (lease with crew, et cetera) aircraft from foreign carriers; U.S. negotiators would be encouraged to drop restrictive "Fly American" provisions (which force government employees to fly on U.S. carriers when traveling abroad, even if this involves detours or delays) in return for similar concessions from our trading partners; and foreign carriers would be allowed to fly U.S. passengers on U.S. domestic routes under certain "emergency" conditions (for instance, when a strike closes down a U.S. carrier). A fourth provision, and the major source of disagreement between the House and the Senate, concerns the CAB's authority over international air fares. Though the board already has substantial authority to disapprove fares under certain conditions, it wants the additional power to set "benchmark" levels above which no fares would be approved. U.S. carriers are lobbying hard against this increase in the board's regulatory authority.

The question of international fares is even more directly at issue before the board itself, in the Show Cause proceeding concerning IATA that commenced in June 1978. There the board contemplates withdrawing the antitrust immunity granted to U.S. and foreign carriers that makes possible IATA's "tariff coordination" activities with respect to traffic between U.S. and foreign points.

IATA came into being at a time when U.S. carriers enjoyed a dominant competitive position in international air passenger service. In 1944 governments of fifty-four nations met in Chicago and agreed that each country's carrier should have a "fair and equal" opportunity to participate in international carriage. Though the Chicago Convention was not ratified by the United States, the "fair and equal" clause led directly to the creation of IATA at a meeting in Havana in 1945 and to "tariff coordination" under IATA. Carriers would meet to determine the fare levels necessary to keep *all* carriers operating at a profit, or at a subsidy their governments could afford; all agreements on fares and service standards would be made unanimously, meaning that no carrier would have to accept a fare too low to cover its costs. The IATA mechanism was given official recognition in the 1946 Bermuda Agreement between the United States and Britain, which specifically refers to IATA as

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the primary means of determining fares between the two countries.

In its 1946 deliberations on IATA, the CAB showed concern over the antitrust implications of allowing de facto price-fixing by the airlines. It was persuaded by several factors, however, that IATA was the best alternative available. First, if IATA constituted a cartel, as some alleged, it certainly was an imperfect one. Under the Bermuda Agreement, and the Bermuda-type agreements negotiated between the United States and most of its other trading partners, IATA has no control over either capacity or entry, two of the three ingredients essential for a perfect cartel. Moreover, IATA agreements are, nominally at least, subject to approval by the governments of the countries to which they apply. So, arguably, the antitrust implications were not as bad as they appeared on the surface. Second, all international air service, U.S. carriers included, was then subsidized anyway —so its was not a matter of purely competitive markets. Third, foreign policy considerations made it difficult to take any action that would have appeared unreceptive to foreign needs. Finally, and probably of greatest importance, the CAB did not have an alternative means of influencing international fares. It could grant antitrust immunity for agreements among carriers under sections 412 and 414 of the Federal Aviation Act, and it could disapprove discriminatory fares under section 1002(f), but it could not generally influence fares submitted by individual carriers. If it failed to approve IATA, the board said in its 1946 opinion, international fares would "be subject to no control by our Government, thereby provoking unilateral control by other governments." So the board approved IATA and simultaneously asked Congress for more general authority over international fares.

But this situation changed in 1972, when the board's request for greater control over international fares was granted. Suddenly, there was an alternative to IATA. There are several possible reasons why the CAB did not act at that time to investigate, and possibly disapprove, its policy of granting antitrust immunity. One is the pro-regulation bent of the board's membership in those days. Another is the fact that IATA seemed to be functioning reasonably well. This is not to say that it was setting rates at efficient levels, for that is not what it was intended to do. Rather, IATA was generally preventing conflicts between governments over fares and setting fares at levels that allowed all carriers, the less efficient as well as the more, an opportunity to participate in the international air travel market.

By 1978 both of these reasons for inaction had disappeared. The CAB was moving forward with domestic deregulation, displaying its willingness to rely on the market. And there were changes in the fundamental character of the market to which IATA was having a difficult time adjusting.

By 1978 the North Atlantic and South Pacific markets had developed to the point where, without question, high-density low-cost services could be operated at a profit. Charters in the North Atlantic and illegal rebating in the South Pacific were giving the traditional IATA carriers competition to which they were not accustomed. The stress in the North Atlantic became so great that in September 1977 the carriers were not able to reach agreement on a new fare structure, and the task of setting fares fell on the governments. Though the two events were not directly related, IATA's inability to reach agreement followed soon after the conclusion of the Bermuda II agreement between the United States and Britain, which provided for increased government control of both capacity and fares. (See "Carter Administration Stumbles at Bermuda" by John W. Barnum, *Regulation*, January/February 1978.) That was only one of many restrictive agreements which had begun to appear (generally in "letters of understanding" and *not* involving the United States) and which were increasing the regulatory component in the aviation market.

In issuing its Show Cause Order of June 1978, the CAB did not list all of these factors as important considerations. Rather, it emphasized the more general differences in circumstances between 1946 and 1978, noting especially that U.S. carriers were no longer the only ones capable of taking part in price competition and that its authority to disapprove rates meant that there was now an alternative to the conference method of rate setting.

In any event, the June order provoked a strong response from IATA itself and from many foreign governments. The People's Republic of China expressed concern that the market, in the event of IATA's demise, would fail to

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In Brief–

All for the Consumers—Again. A special ceremony was held in the White House on September 26 to mark the signing of an executive order that administration officials claimed would work toward the same ends as the proposed independent consumer protection agency, several times defeated in Congress. Advocates of the independent agency are unlikely to regard the new program as an adequate substitute. It calls for placing consumer representatives in each federal agency, supervised in some way by a Consumer Council whose members are drawn from all Cabinet departments. Neither the council nor the new consumer units within the agencies will have the authority to contest new regulations in court, nor the visibility and resulting clout, that the independent agency was supposed to possess. The council's role, it appears, will be limited to ensuring that agencies do establish the consumer representation procedures laid down in the order, though its powers and resources even for that are uncertain.

Opponents of the original proposal, by the same token, have no reason to see this as an end-run around congressional resistance to a radical new scheme. Back in September 1976, President Ford issued a memorandum requiring federal agencies to assign personnel to respond to consumer complaints and to facilitate consumer participation in rulemaking proceedings. Carter administration officials claim their effort is different because the new order (three pages in all) is more "specific" about the responsibilities of these in-house consumer representatives and requires that at least some of them serve full-time in this role. Otherwise it differs only by the decorative addition of the Consumer Council. One other difference: President Ford established his program to assist in defeating the independent agency proposal in Congress, whereas President Carter acted to assuage supporters after his administration's efforts to achieve such legislation failed. The in-house consumer rep appears to be a scam for all seasons—serving political ends equally well, whether coming or going.

Hurdles for a Different Race. It is often charged that "slow growth" regulatory policies tend to favor established groups while imposing disproportionate hardships on minorities. A recent case in Hawaii illustrates the phenomenon—and also suggests the interesting question of when reverse discrimination is not reverse discrimination. Two dentists from the mainland charged in federal court last year that the State Board of Dental Examiners in Hawaii—six of whose seven members are of Asian descent—was systematically discriminating against newcomers to Hawaii, and against Caucasians generally, in the grading of dental licensing exams. A federal judge upheld the charge and ordered extensive changes in the way the licensing exams are administered.

Evidence submitted in the case indicated that from 1974 to 1977, more than 90 percent of the Japanese-Americans taking the state dental exams were given licenses to practice, compared to only 33 percent of the Caucasians. Prior to 1974, more than three-quarters of the Caucasians were regularly successful. It was in 1974 that Governor George Ariyoshi, an advocate of limiting Hawaii's population growth, was sworn into office. Japanese-Americans currently constitute about 42 percent of the islands' registered voters, but the white population, now 26 percent of the electorate, has been growing steadily for a decade. The decision in the dentistry case may presage further judicial vetoes of Ariyoshi's programs for discouraging immigration by burdening new residents with special taxes and curtailed opportunities for employment.

Flying Dust. Regulations designed to protect textile workers from cotton dust—a prime source of "brown lung" disease—were upheld by the Court of Appeals for the District of Columbia on October 24. In protesting these regulations of the Occupational Safety and Health Administration, the textile industry had argued that mill workers could enjoy the same degree of safety, even at higher levels of cotton dust exposure than allowed by the OSHA standard, if they were simply required to wear respirators while in certain factory areas. OSHA decided, instead, to require textile plants to install millions of dollars worth of special equipment on the grounds that respirators would be uncomfortable for workers and so unlikely to be worn. Industry advocates got nowhere with the argument that the textile firms could be expected to control the performance of their employees at least as well as the performance of their equipment. The Court held that OSHA's decision was not so unreasonable as to warrant reversal, however, and noted: "Even if a few firms are forced to shut down, the standard is not necessarily economically infeasible."

set a "standard of prices." Other countries, along with IATA, echoed the sentiment. Many countries, moreover, expressed the understandable concern that their home carriers would not be able to survive unrestricted competition.

The Department of State, responding to these foreign complaints that the CAB's order amounted to "unilateralism" on the part of the United States, submitted a plea that the board either tone down or terminate its investigation, a position with which the Department of Transportation agreed. The Department of Justice, on the other hand, sided with the sentiment expressed in the Show Cause Order.

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Finally, during the week of October 22, 1979, the board heard testimony on a "toned-down" version of its original order. Whereas the original proposal considered removing antitrust immunity for all of IATA's functions, the new version would disapprove only those activities relating to fare-setting and would allow certain "facilitation" agreements to stand (for example, agreements to use standardized baggage tickets). More important, the new version would limit the removal of antitrust immunity to traffic originating or terminating in the United States. No longer would it be possible for the Department of Justice (or a private citizen) to pursue an antitrust suit against carriers that collectively set rates for routes between foreign points. This latter change, though it did not satisfy IATA, goes most of the way to meet the original criticism that the United States was trying to make the world conform to its antitrust laws. It still permits, however, prosecution of foreign (as well as domestic) carriers that cooperatively set rates to and from U.S. points. At the hearings, CAB members asked witnesses about ways of further weakening the initiative, possibly by granting IATA continued immunity on a conditional basis.

With the CAB having general control over fares and with only two U.S. carriers (National and Flying Tiger) still participating in IATA fare setting, the outcome of the Show Cause proceeding is not likely to have any appreciable, immediate effect on the level of fares. It could have some effect in the future—if, for example, the board decided to continue granting antitrust immunity and U.S. carriers rejoined IATA's fare-setting conferences (a possibility suggested, in fact, in IATA's argument). If U.S. carriers did this and if the board's consumer-oriented philosophy changed, a return to more restrictive competition and higher fares would probably result.

The CAB's initiative and the legislative proposals discussed earlier exemplify an interesting phenomenon. As the United States moves domestically toward less regulation and more reliance on the market, it will display a similar tendency in the international arena. This is partially a matter of institutional dynamics: a CAB and a Congress which have been disposed to deregulate the domestic market and are satisfied with the effects of deregulation will naturally be inclined to advocate competition in international markets as well. But it is also a matter of economics: regulation and competition are uneasy bedfellows, and competitive domestic markets place pressures on regulated international regimes.

It would be premature, however, to regard the United States as an acknowledged champion of free trade. The IATA debate in fact contained repetition of the old charge that we support free trade only when it is in our narrow and immediate interest to do so. Our apparent readiness to open up international aviation certainly does not disprove the charge, since in that field we appear to have a marked competitive advantage. But in ocean shipping, for example, where the competitive edge is elsewhere, we have made no effort to push deregulation. In other areas as well—so-called orderly marketing agreements for shoes and TV sets, cartel-like arrangements in steel and textiles—the United States is substantially involved in regulating international commerce.

A Drug on the Export Market

In 1975 a report by the United Nations Conference on Trade and Development charged that the greed of multinational pharmaceutical companies was depriving Third World nations of the full range of drugs they need to treat indigenous diseases. Last year a report by the United Nations Industrial Development Organization made substantially the same charge (unsurprisingly, since it was written by the same man). This spring, Senator Edward Kennedy's health subcommittee approved a bill implicitly acknowledging that the U.S. government is partly to blame for this situation.

Under existing law, the Food and Drug Administration cannot approve a new drug for domestic sale *or for export* (in official parlance, cannot grant an approved new drug application, or NDA) until the drug passes an elaborate series of tests for safety and efficacy. Furthermore, drugs cannot in fact be exported for investigative purposes without the FDA's granting an investigational new drug exemption, or IND. Yet even though the United States is the only country requiring approval for such export, the matter, while a hassle, seems not to represent an insurmountable problem.

The largest problem is that the FDA judges

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new drug applications by essentially the same criteria no matter what market the drugs involved may be aimed at. Thus a drug for schistosomiasis would probably not receive an NDA if the drug posed some risk of dangerous side effects, because the risks would seem excessive for treating a disease that is almost nonexistent in the United States. But refusal of the NDA would then bar export of the drug to a country like Brazil, which might be willing to accept the same risks in order to provide effective treatment for a disease that attacks up to 100 percent of the population in its vast Northeast Province. Moreover, the process leading to the NDA requires testing on human subjects on a fairly broad scale and the FDA has historically been unwilling to accept as grounds for approval the results of tests carried out anywhere but in the United States. In the United States, however, tropical diseases are so rare that testing here (except for leprosy) is impossible. Which means that drugs for these tropical diseases are unlikely to receive the NDA necessary for export.

Such considerations have discouraged U.S.-based firms from developing drugs for tropical diseases. Rules designed to ensure the quality of drug testing and to protect Third World countries from becoming dumping grounds for dangerous drugs have actually worked against the health needs of the Third World.

The export provisions of the proposed Drug Regulatory Reform Act of 1979 (S. 1075) are designed to remedy this situation. They would permit the export of a drug without the NDA if that drug has the approval of the country of destination and is not "contrary to public health and safety." At the urging of Senator Jacob Javits, however, Senator Kennedy's health subcommittee has altered the bill so that the effective date of the proposed changes would be delayed until a Task Force on Drug Export Policy (with a six-month life) can develop more detailed ground rules for the licensing of new drugs destined for overseas. The task force's recommendations should be able to deal with residual concerns about using Third World peoples as guinea pigs. But there is some fear that these recommendations may let the FDA take away with one hand what has been granted with the other. After all, the FDA has previously promulgated a rule to the effect that the results of foreign tests can in some cases be accepted for the NDA—but has only accepted them as pivotal evidence in a couple of very recent cases.

In any event, a change in U.S. regulatory policy, though welcome, would still make only a small contribution to the underlying health problems of the underdeveloped nations—even though it might remove some of the disincentives for drug companies to work on Third World diseases. In that work, as in the development and testing of any new drug, pharmaceutical researchers must be able to compare the drug's effects on a sample group of subjects with its effects on a comparable control group in nearly the same state of health. But in the less-developed countries where tropical diseases are most common, the victimized populations often have so many different diseases that it is hard to isolate appropriate sample and control groups. Moreover, wide-scale poverty and isolation, shortages of doctors and health-care workers, inadequate transportation and communication networks—in short, the array of economic problems implied by "underdeveloped"—make it difficult for these countries to deliver even currently available drugs to the people who need them. And it is also this condition of economic underdevelopment, of course, that makes these tropical countries so dependent on the pharmaceutical research capabilities of foreign—including American—drug companies in the first place. U.S. regulation can hardly be blamed for these problems. But it would be a welcome change, at least, if it no longer exacerbated them.

Large Changes for Small Business

Committees in both houses of Congress began to labor in earnest last month on two bills that may herald a far-reaching change in federal regulatory policy. The measures amount to a mandate for the creation of a special protective niche for small business enterprise and would, if passed, force agencies throughout the federal government to alter existing regulations accordingly. There is by now broad recognition in Congress that the cumulative burdens of federal regulation and tax policy have had a severe impact on the start-up and development of small firms. It is a testimony to the depth of the problem—and to its disturbing implica-

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tions for the economy as a whole—that the sweeping measures now under consideration have already gained strong support in Congress.

Concern about the problems of small firms is by no means a matter of nostalgia for the simpler economy of the past. For it turns out that small business has played a disproportionately important role in developing new technologies and creating jobs. Perhaps small firms are highly innovative because, with less to lose, they tend to be less risk averse than corporate giants—or because small entrepreneurs are typically more free to pursue daring hunches, more assured of reaping the financial rewards, or simply more lean and hungry than their counterparts in larger organizations. In any event, a recent study by the National Science Foundation concluded that, in the period since World War II, firms with less than 1,000 employees were responsible for half of the "most significant new industrial products and processes" and that firms with fewer than 100 employees produced almost a quarter of these innovations. Equally important, small new-technology firms often grow with startling rapidity, creating more and more new jobs along the way: a study done at the Massachusetts Institute of Technology found that, between 1969 and 1974, the number of jobs in a sample of "young, high-technology companies" grew faster than 40 percent a year compounded annually, compared with barely half a percent for a sample of major "mature" corporations. Studies recently brought together by the Small Business Administration suggest a strong connection between the staggering decline in the creation and development of small businesses in the last decade and the steady fall-off in industrial innovativeness—as reflected, for example, in sharp decreases in productivity improvement. This in turn suggests that the troubles of the small business sector may have a very important relation to the larger problems of the American economy.

The most severe difficulty faced by small entrepreneurs has been a drastic reduction in capital sources. By the late 1970s, the capital that small firms (those with less than $5 billion in net worth) acquired annually from public markets was barely one-tenth of what it had been in 1969. In large part, undoubtedly, this reflected the sharply increased tax rate on capital gains enacted in 1969, which made investors less willing to risk their money on new ventures and reduced the incentive for salaried executives of established corporations to start firms of their own. Not surprisingly, then, reductions in the capital gains tax rate voted by Congress in 1978 have already stimulated a considerable increase in the start-up of new small businesses.

But federal regulation has also posed sizable obstacles for small business development—even in the area of capital formation. Securities and Exchange Commission rules have imposed highly disproportionate costs on the public offerings of small firms, by requiring them to meet the same elaborate registration and disclosure standards as large corporations. This problem was also eased last year, when the ceiling for abbreviated registration requirements was raised from offerings of $500,000 to $1,500,000. But the SEC concedes that some of its regulations (like those affecting private offerings) may present special difficulties for small firms. Similarly, provisions of the Employee Retirement Income Security Act imposing stringent but vaguely worded standards of "prudent investment" have made pension fund managers fearful of risking even a small portion of their enormous funds on the growth potential of small firms. Here, too, the problem has recently been lessened via a Labor Department interpretation applying the prudence test not to each separate investment but to the state of the overall portfolio.

In addition, the newer social regulatory agencies established in the last decade have, in various unforeseen ways, created specially onerous problems for small businesses. This is often the case simply because small firms have fewer resources, less experience, and less ability to apply economies of scale to regulatory compliance costs. Thus, for example, the small business participants in a recent Domestic Policy Review on industrial innovation, prepared at White House request, were so incensed by the costs associated with regulations of the Occupational Safety and Health Administration that they urged a presumptive exemption for small business from *all* OSHA jurisdiction.

The proposed Smaller Enterprise Regulatory Improvement Act (H.R. 4660) rests on the premise that much of the regulatory burden on small business is, in fact, unnecessary. Un-

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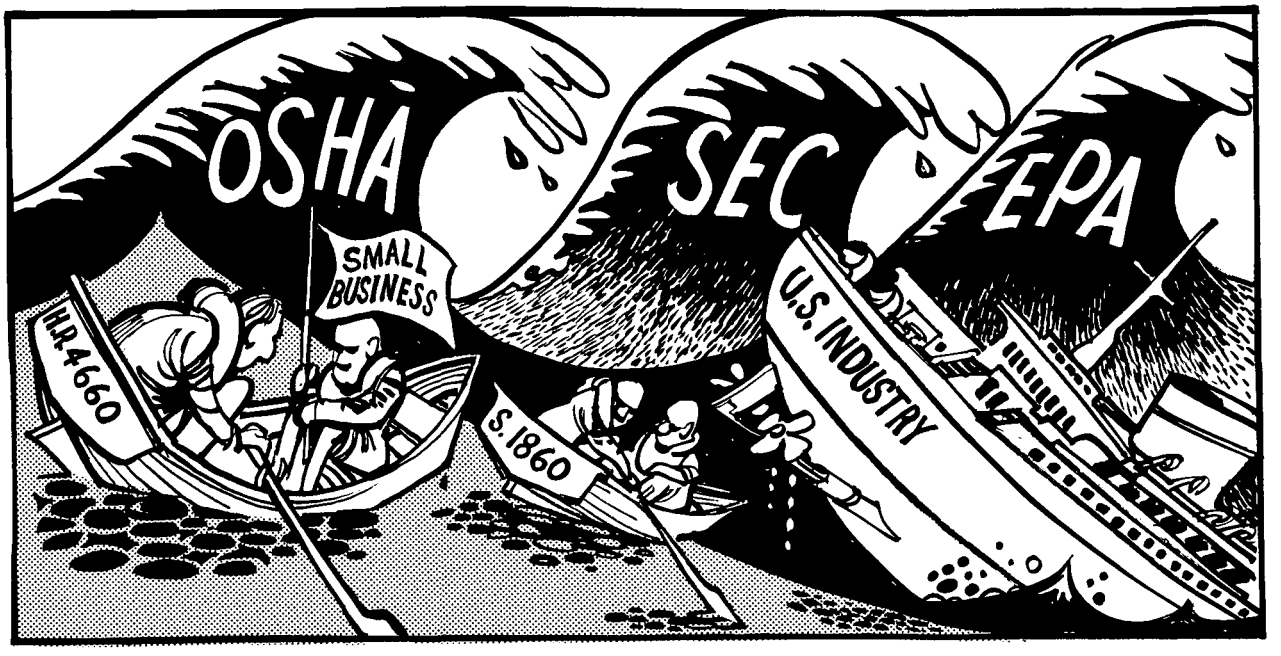
der this bill, all federal agencies would be required to publish analyses of the effects of each new regulatory proposal on small business. When such analysis indicates that it is "lawful, desirable and feasible" to do so, the agency would have to exempt small businesses from the regulation in question (if their compliance would be of "minimal value" in achieving the regulatory purpose) or at least would have to establish "appropriate differing and less burdensome requirements" (including modifications in performance standards, compliance timetables, and routine reporting requirements). The bill would also require agencies to apply the same process of analysis and modification to all their existing regulations over the next ten years. Though the bill defines "small business" by reference to the Small Business Act, it would allow agencies to establish different definitions as appropriate to their own circumstances (while also requiring them to consider special regulatory status for unincorporated businesses, sheltered workshops, small and independent "not-for-profit enterprises," and other "small organizations").

The Senate version of this proposal is similar in language and structure (though cast as an amendment to the Administrative Procedure Act and not, like the House bill, to the Small Business Act). Essentially the same bill that passed the Senate last year, it has now been incorporated as Title IV of the proposed Small Business Innovation Act of 1979 (S. 1860). It differs from the House version principally by including "small governmental jurisdictions" (defined as local governments, school districts, or special service districts serving populations of less than 100,000) and "individuals" (except in their capacities as members of business or governmental organizations). It is also somewhat more specific about the procedures the agencies would have to follow in considering regulatory modifications and more emphatic about their obligation to seek out suggestions and advice from small business in doing so.

Since these bills essentially mandate procedures for reconsideration rather than specific changes in regulations—and since their abstract directives to the agencies are qualified by numerous cautionary phrases—it is hard to predict how soon or to what extent they might produce the sort of "two-tiered" regulatory system envisioned by their sponsors. In trying to take on reform of the whole regulatory system at once, Congress leaves it entirely to the agencies themselves, in the first instance, to distinguish essential regulatory aims or requirements from those that can be prudently compromised in the interest of lessening the burdens on small business. It is the legislative course of least resistance—and also, perhaps, of least effect—to endorse the elimination of inessential burdensome requirements on small business, while remaining noncommittal about



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what is inessential. If the bill is passed, one can expect this problem to join the many other political determinations now being pressed upon the courts.

These proposals also raise larger questions. The objective of relieving the disproportionate regulatory burden on small businesses can easily deteriorate into the objective of handicapping big business—and it is hard to tell where the one begins and the other ends. This consideration prompts reflection, not only on abstract questions of fairness, but also on some basic issues of economic policy and political balance. In many industries, there are undeniable economies of scale, and in many areas large research units are vital to innovation—so that a policy of systematically favoring small business can often amount to a policy of systematically penalizing the consumer. Moreover, the larger movement toward deregulation may be seriously weakened if small business is split away from the reform coalition by special regulatory exemptions. Is it foolish to fear that small business interests may even come to champion more stringent and inflexible regulation for their larger competitors?

In its eagerness to do something dramatic to help small business, Congress does not seem to be giving much thought to the considerable potential for trouble in the new regulatory approach. It is not reassuring, for example, that the Senate version of this proposal has been attached to a bill that accords special benefits to small businesses in tax code provisions, procurement policies, patent procedures, and research funding—all of which rather clearly goes beyond eliminating special burdens on small firms, and would confer substantial subsidies on their activity.

Rum, Federalism, and Regulation

Within the last decade or so, most of the traditionally regulated industries—transportation, banking, even public utilities — have been opened (more or less) to competition by legislated regulatory reform. Contemporaneously, the Supreme Court has steadily broadened the reach of the federal antitrust laws by cutting back upon antitrust exemptions, including most importantly the so-called state-action exemption, which protects those enveloped by state regulatory schemes from antitrust liability (see "Antitrust Comes to City Hall" by Joe Sims, *Regulation*, July/August 1979).

Until recently, the liquor industry has been safe from antitrust attack, and has stood as one of the last bastions of private market stabilization. A major reason is the Twenty-first Amendment (repealing prohibition), which has been viewed as an impediment to federal disruption of state liquor regulation schemes. Now, however, that view has been challenged, and the industry is fighting to preserve its regulated way of life. The issue has come to the Supreme Court in the case of *California Retail Liquor Dealers* v. *Midcal Aluminum*.

In *Midcal*, the California Alcoholic Beverages Control Board cited a retailer for selling wine below the minimum price posted by the manufacturer. Under California law, wine manufacturers were required to file minimum price schedules with the state, and retailers were prohibited from selling at less than those posted prices. Only a year ago, in *Rice* v. *Alcoholic Beverages Control Board*, the California Supreme Court had invalidated a similar regulatory scheme for liquor and beer. In *Midcal*, the California Court of Appeals followed the *Rice* rationale and set aside the citation. The California Supreme Court declined appeal, and the California Retail Liquor Dealers Association (which had intervened on the side of the ABC Board in order to present the industry view) filed a petition for review by the U.S. Supreme Court. That petition has now been granted.

Although the Twenty-first Amendment has been perceived as delegating to the states the right to regulate the sale of liquor within their respective boundaries, that is not what the amendment actually says. It provides that "the transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." Of late, some federal courts have concluded that the amendment applies *only* to "the transportation or importation" of alcoholic beverages, reasoning that it was intended to allow "dry" states to keep the stuff out, but not necessarily to give the states carte blanche over liquor regulation.

The California Supreme Court adopted this view and concluded that the state scheme was not protected by the Twenty-first Amendment

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because its effectiveness in achieving the state goals of fostering temperance and protecting smaller sellers was outweighed by its destructive impact upon federal antitrust policy expressed in the Sherman Act. This "balancing test," reminiscent of that used by the U.S. Supreme Court in commerce clause and federal preemption cases, was applied by the California Supreme Court in the portion of its opinion treating the Twenty-first Amendment; but had that issue not been in the case, the same balancing would presumably have been undertaken in the portion dealing with Sherman Act preemption.

If the U.S. Supreme Court disposes of the *Midcal* appeal by deciding that the traditional, expansive interpretation of the Twenty-first Amendment is correct, committing liquor regulation absolutely to state control, the case will be important to imbibers and purveyors of strong drink, but not terribly significant otherwise. If, on the other hand, the Court agrees with the more limited view of the Twenty-first Amendment or if it chooses (as is sound judicial practice) to take up that constitutional issue last, it must then confront the question of much more general consequence: whether the Sherman Act preempts state regulatory laws.

The California Supreme Court disposed of this issue by finding that preemption can occur, at least where the particular anticompetitive action required by state law (in *Midcal,* the establishment of the *specific* posted prices) is not actually directed or approved by a state agency, but is left within the discretion of private entities. In pursuing this analysis, the California court relied heavily upon its reading of the U.S. Supreme Court's opinions in cases involving the state-action exemption. To connoisseurs of federal antitrust law, this may seem strange. For the state-action exemption, as its name implies, relates to the dispensation of private entities from civil or criminal liability under the Sherman Act. It has never been used by the U.S. Supreme Court directly to confront the issue involved in *Midcal*—whether a state regulatory scheme has been preempted. But at bottom the state-action exemption does rest upon preemption considerations, since it essentially answers the question whether Congress intended private conduct to be controlled exclusively by the Sherman Act or, in the case of conflict with a regulatory statute, by state law.

It is clear, then, that if the U.S. Supreme Court adopts the California courts' view with respect to the preemption issue, the scope of the state-action exemption will be substantially constricted. Though recently narrowed in other respects, it has been thought to accord immunity to all private action *required* (even if not to all private action *permitted*) by state regulation. Such a view is obviously incompatible with *Midcal*'s principle that state regulatory requirements leaving substantial discretion to private entities are invalidated by the Sherman Act.

But the real novelty of *Midcal* is the latter principle itself—the use of the Sherman Act not merely to impose prohibitions upon private action, but directly to override state business regulation. The enormity of the difference is apparent from the nature of the *Midcal* lawsuit itself. Unlike the standard state-action exemption case, *Midcal* is not a Sherman Act prosecution or civil suit, but a direct attack upon the California liquor scheme.

If the U.S. Supreme Court were to agree with the California courts, the consequences would be far-reaching. Many state regulatory schemes flatly inconsistent with the policy of free competition would presumably be stricken down. But a Supreme Court affirmance seems unlikely. It is contrary to reasonable principles of federalism to discover in the ninety-year-old Sherman Act at this late date an implicit intent incidentally to overturn vast areas of traditional state legislation. And it is positively perverse to do so when a large number of federal laws are at least equivalently inconsistent with the supposed pro-competitive absolutism.

A similar issue (though not in the extreme context of self-operative Sherman Act displacement of state law) is involved in the Federal Trade Commission's announced intention to preempt various state statutes by issuing trade regulation rules. That matter is also in litigation, and probably on its way to the Supreme Court; so the FTC among others will be watching *Midcal* closely. While the thrill of uncertainty accompanies any litigation, it seems likely that the Court accepted this case to correct what might be good public policy but is probably bad law, rather than to announce a new national rule of wider mandatory competition. The answer should come sometime around June 1980.

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Viewpoint

John H. Shenefield

Government Enterprise–A New Frontier for Regulatory Reformers

THE PAST AND PRESENT of deregulation is among the best and the brightest of Washington's political topics. Virtually all once and future social engineers seem to have written extensively on the subject, and critics of regulation—flushed with victories in the air cargo and air passenger industries—are zeroing in on other federal protectorates on the ground and at sea. Predictably, those enjoying life in the protectorates are marshaling their strength to persuade Congress that—in their cases at least—regulation represents a "particularly advanced form of free enterprise capitalism" (the phrase is John Kenneth Galbraith's).

Five years ago, who would have predicted it? In those days, deregulators were accused of trying to remodel the Alhambra with a steam shovel. But two presidents in succession—Gerald Ford and Jimmy Carter—have given the deregulatory effort substantial force and respectability. In the past few years, we have capped the trend toward proliferating federal agencies that produced more than fifty new regulatory programs between 1960 and 1975. We have rolled back economic regulation, most notably in air cargo and air passenger service. We have had Executive Order 12044, which requires executive branch regulators to consider the economic impact of their regulations. And we have begun to realize, and to act on the realization, that not everyone can sit down at the budgetary banquet at the same time—that, in short, we have to set priorities. Now, with an efficiency-oriented White House, a cost-conscious Congress, and most of the necessary building (or unbuilding) blocks assembled for deregulation, the future looks bright for the free market. Or does it?

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Not So Free Markets

Not quite. There are countervailing forces that point toward more, not less, government involvement in the economy—forces having to do with the nature of some of the problems we confront and with the increasing politicization of important economic issues. Let me explain.

First, what do I mean by the "nature of the problems"? Environmentalists, for example, have been arguing ever since the days of early Rachel Carson that we must take externalities into account, particularly the externality of air and water pollution; and policy makers now largely agree that government should intervene to take account of these externalities. Where they disagree, and here the differences are substantial, is on the form the intervention should take. While there is at present an opportunity to minimize the degree of direct regulatory interference (by using pollution taxes, for example), experience justifies the expectation of more intrusive forms of regulatory control. It is important to remember that the kind of regulation we choose for pursuing important social goals has significant implications for the efficient operation of our economy.

Second, what do I mean by the "politicization" of economic issues? Increasingly today our resource allocation decisions are being made in the political arena, a development that Senator Moynihan, for one, finds an inevitable consequence of an already large and intrusive government. As that government becomes more

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and more the dispenser of desirable goods and services, groups within society coalesce at a geometric rate, to lobby for their "rightful" share. Moreover, this tendency to seek an allocation through the political rather than the market process is accelerated when the public perceives that the economic "pie" has ceased to grow at historic rates.

But if the nature of certain problems and the growing politicization of resource allocation decisions do not drive the government to more active intervention, there is yet another force that might do so. That is the trend toward straight government enterprise—toward the marketplace presence of the government as businessman. Robert Heilbroner has argued that there are three stages in the development of government policies toward the economy, each more interventionist than its predecessor, and that we are moving towards—or have already entered—the last of these stages. In the first stage, the federal government promotes "desirable" private sector activities, as when Congress gave some 131 million acres to the railroads in 1862. Then, government regulates the terms under which these presumptively desirable quasi-public services are offered to the public, as when it began modern regulation with the Interstate Commerce Commission in 1887. There follows, eventually, the third or "guarantor" stage, typified by the bail-out of Lockheed, Conrail, and Amtrak. Because the services involved (defense contracting, transportation) are quasi-public and provided by virtue of public policy, government must act to ensure their availability on "reasonable" terms. This can be accomplished, the argument goes, through loan guarantees, direct subsidies, special statutory "trusts," public corporations, and so on.

The problem of government enterprise in our market economy is not of itself new. The federal government has spent $70 billion on interstate highways—to the great benefit of the trucking and bus industries. In addition, federal outlays to railroad programs (Amtrak and Conrail essentially) totaled $1.8 billion in 1978, and federal loans to Conrail to establish self-supporting service in the Northeast and Midwest are estimated at $2.1 billion for 1979. Along with what is almost de facto nationalization of significant parts of the rail business, the government is now spending over $2 billion a year on urban mass transit to help provide services that until fairly recently were largely private sector offerings. For another example, though the figures on the Defense Department's "nonappropriated fund" activities are obscure, the indications are that the department (through its nationwide network of grocery, variety, and liquor stores, *and* its night clubs, golf courses, and miscellaneous leisure activities) ranks as one of the country's five or six largest retailers. The U.S. Postal Service now has total annual revenues of about $18 billion, slightly above those of IBM; and, though it has yet to adapt its commercial operations to accommodate cash registers, it is currently considering spending some $2 *billion* to diversify into electronic computer-related communications.

Skewing the Signals

It is obvious that the government is already substantially engaged in businesses carried on in the marketplace. Moreover, to the extent that arguments for public guarantees of one sort or another find political acceptance, the role of the government in the economy will increase, not decline. And from the standpoint of antitrust policy, the implications of expanded government enterprise are clear.

Our system depends on price and profit, for example, to stimulate the flow of investment in the "right" directions. That is, both price and profit are agents of efficiency. The traditional assumption has been that in an effectively competitive market, price will tend to be aligned, more or less, with marginal cost. Firms in the market will be assisted by consumers' signals—the prices consumers are willing to pay—in making their resource allocations. Similarly, firms that are considering a move into a market will tend to be guided by a comparison of prevailing prices and what they believe the costs of new entry will be. The pricing signals generated in many businesses are imperfect at best. We rely on them generally, however, to reflect underlying scarcities and thus to encourage private acts of investment, conservation, and the generation of new technologies.

Of course, pricing signals can be skewed by government policy. This has occurred in the energy market, where prices have been driven

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to artificially low levels, and in ocean shipping, where demand appears to have been artificially suppressed by government actions aimed at maintaining overly high prices. Here it is important to realize that, while traditional regulation *can* affect the integrity and accuracy of pricing signals, the presence of substantial de facto or de jure government enterprise in an industry almost certainly *will* skew them. When the government owns a particular enterprise, it is exceedingly difficult for politicians and bureaucrats not to manipulate the prices the enterprise charges—this for a variety of usually well-meaning purposes. Because government enterprises either cannot, or are not allowed to, determine prices on the basis of commercial realities, "islands of chaos" tend to materialize in centrally planned economies.

In addition, government enterprise typically entails the loss of the discipline inherent in private competitive markets. Special institutional arrangements and public commitments notwithstanding, it is a fact of life that even the most inefficient and wasteful government enterprise will never have to close down, since it will have access to sources of capital and day-to-day financial nourishment quite independent of its commercial operations. Thus, government enterprises generally appear to have adverse effects on the pricing mechanisms we ordinarily depend on for resource allocation, effects similar to those associated with "simple" regulation. But for government enterprise, the skewing effects are much closer to being certain and, when they come, are probably more severe.

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Government enterprise also leads in the long run to a decrease in public accountability. Precisely because a particular public authority is acting on behalf of a generalized "public interest," it may cease to be subject to laws that frame the rest of the marketplace—laws on disclosure, antitrust, sometimes even health and safety. Service of the public interest at large leads to avoidance of public responsibility.

In criticizing government enterprises, I obviously do not mean to slander those that we already have. Many of them serve valuable nonmarket-related purposes. But one can, without being inconsistent, accept the existing enterprises and still be strongly opposed to adding more.

What Is To Be Done?

While we appear to be winning a battle against traditional forms of economic regulation, we may not be winning the overall war. Those special forms of government involvement that wind up with government enterprise have very substantial policy implications, but we still are only dimly aware of what those implications are. Here is, I believe, a new opportunity for constructive deregulation.

What should we be doing in these new areas? In the case of more traditional regulation, the literature is comprehensive and the case for deregulation is compelling. In this new area, however, much of the basic analytical work has yet to be done. The Antitrust Division of the Department of Justice is turning its attention to the largely uncharted phenomenon of government as a direct participant in the marketplace. In that effort, a lesson from previous regulatory experience must be remembered: the importance of being exceedingly cautious about embracing innovative "solutions" that discard or interfere with efficient markets. There was a time—not long ago—when it was regulation in particular, and government intervention in general, that seemed the best and the brightest of new ideas. But the wheel has turned.

As policy makers consider the competitive implications of the government as guarantor or (it is only a short step further) as businessman in the marketplace, they might take to heart the advice of Jeremy Bentham a century and a half ago. The best action for government to take in that role and in that marketplace, he wrote, is to "Do nothing—keep quiet." ■

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THE LEGISLATIVE VETO: A FALSE REMEDY FOR SYSTEM OVERLOAD

Antonin Scalia

THE CURRENT movement for regulatory reform has given new popularity to the legislative veto. That is the device whereby executive action authorized by statute is made subject to prior disapproval by one (the so-called one-house veto) or both (the two-house veto) houses of Congress. There is of course nothing remarkable about the ability of Congress to stay or revoke executive action which it has previously authorized; but the distinctive feature of the legislative veto is that it enables this to be accomplished by mere resolution—not formal legislation—thus avoiding the President's veto power and (in the case of the one-house veto) the requirement of approval by both houses.

Although there are now well over a hundred examples of the legislative veto on the statute books, it is a relatively recent addition to our governmental machinery, first appearing in 1932 and only recurring a few times between then and World War II. In the past decade it has become more common—though almost always directed at a relatively narrow and specific executive action, such as the granting of pay raises to government officials. (To say it has become more common is not to imply that its validity has become accepted; presidents from Franklin Roosevelt to Jimmy Carter have questioned its constitutionality, as have many congressional leaders as well.) Several regulatory reform proposals now before Congress would attach the legislative veto to all agency rulemaking, as a means of "getting control of the bureaucracy." Such action would elevate the device from an occasional oddity to a fundamental feature of our government. Before that occurs, it is worth considering whether the legislative veto accords with our political system and will provide the benefits that are promised.

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The Role of Congress in Constitutional Interpretation

I often think that legislators—and the general public, for that matter—must be thoroughly sick of the spectacle of lawyers and legal scholars arguing that this or that feature of proposed legislation is contrary to the Constitution. We live in an age of "hair-trigger unconstitutionality," and almost no result produced or about to be produced by the democratic process at any level of government seems immune from attack by some Scribe or Pharisee with a law degree on the ground that it contravenes the Basic Charter of our Liberties. Such facile invocation of the Constitution produces some destructive results. One is a massive increase in the power of the courts—which is why they so readily indulge it. Another is the debasement of what might be termed an erosion of the legislature's constitutional ethic. Hearing solemn and contradictory invocation of the Founding Fathers so often, and knowing that the Supreme Court will in any event have

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the last word, the people's representatives are increasingly inclined simply to produce the legislation which in their view has the most beneficial substantive effects, and leave the constitutional nit-picking to the courts.

They must resist that understandable inclination. Congress has an authority and indeed a responsibility to interpret the Constitution that are no less solemn and binding than the similar authority and responsibility of the Supreme Court—because they spring from the same source, which is the obligation to take no action that would contravene that document. Moreover, congressional interpretations are of enormous importance—of greater importance, ultimately, than those of the Supreme Court. It is not unrealistic to regard our constitutional law as divided into two strata: the higher (and more important) established by Congress, in its refusal to pass legislation contrary to our society's understanding of the basic principles that govern our polity; and the lower established by the courts, in striking down those few congressional enactments that are, in the judges' more restricted purview, contrary to the Constitution.

. . . congressional interpretations [of the Constitution] are of enormous importance—of greater importance, ultimately, than those of the Supreme Court.

And they *are* few. However activist the federal courts may have become with respect to state legislation, in the nearly two centuries of our republic only about 100 acts of Congress have been stricken down, in whole or in part. Congress is, in other words, the first line of constitutional defense, and the courts—even the activist modern courts—merely a backstop. Moreover, the character of what might be called congressionally applied constitutional law ultimately affects the character of the judicially applied stratum beneath it. This may or may not be desirable, but it is unquestionably true. As enduring congressional notions of constitutional limitations have changed—with respect, for example, to the scope of federal commerce-clause power, the permissible degree of governmental intrusion upon private economic activities, or the permissible extent of delegation of congressional authority—so also have the notions of the courts.

This amounts to saying no more (and no less) than that constitutional provisions subsist only as long as they remain not merely imprinted on paper, but also embedded in the thinking of the people. When our people ceased to believe in a federal government of narrowly limited powers, Congress's constitutional interpretation disregarded such limitations, and the courts soon followed. What is involved in a consideration of the legislative veto is the question whether the doctrine of separation of powers and the principle that laws can only be passed by affirmative vote of the people's representatives are ready for a similar fate.

The Constitutional Text

The Constitution, in Article I, section 7, clause 2, gives the President a major role in the enactment of laws—by providing that all bills passed by Congress are subject to his disapproval, which can be overridden only by two-thirds vote of each house. That "bill veto" clause is succeeded by the following provision, which is central to the issue here under discussion:

> Every order, resolution, or vote, to which the concurrence of the Senate and House of Representatives may be necessary (except on a question of adjournment) shall be presented to the President of the United States; and before the same shall take effect, shall be approved by him, or being disapproved by him, shall be repassed by two thirds of the Senate and House of Representatives, according to the rules and limitations prescribed in the case of a bill.

The purpose of this provision, as confirmed by accounts of the debate at the Constitutional Convention, is to prevent Congress from evading the President's legislative role (as some state legislatures before 1789 had evaded gubernatorial veto powers) by simply acting through measures that are not called "bills." It was meant to ensure presidential participation in *all* lawmaking, under whatever form it might disguise itself. The validity of the legislative veto, then, turns quite simply upon whether it in reality constitutes lawmaking. I think it difficult to maintain that it does not.

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Laws can generally be divided into two types, which sometimes overlap: The first confers rights and obligations upon private individuals. The second—which is more common at the federal level—confers powers or imposes prohibitions upon executive (or, more rarely, judicial) officials. The Corps of Engineers, for example, is given authority to construct dams or is prohibited from taking any action which would adversely affect endangered species of wildlife. Now it is undeniable, I think, that the withdrawal of executive power previously conferred—that is to say, the prohibition of executive action which is currently legitimate—can only be done *by law*, that is, by that process which invokes the presidential veto power. Reduced to its essence, the argument for the legislative veto is that this situation changes when the empowering law *itself* states, in so many words, that the power conferred may be withdrawn by Congress, without further presidential participation in the process. Then, the argument goes, the power initially conferred contains *within* it this built-in limitation of congressional retractability, so nothing is later taken away, and therefore no new "law" is really made.

This seems to me insupportable. If the Founding Fathers, who were so concerned about protecting the President's participation in the legislative process that they added to the "bill veto" clause the super-cautious language of Article I, section 7, clause 3, succeeded by all their efforts in requiring no more than that Congress say in advance, for each law it passes, that the President will have no part in the amending or repeal of such law—then they were feckless indeed. Consider the possibilities: "There is hereby created a Department of Education, which shall have powers X, Y, and Z, but only for so long as Congress approves such Department and powers; and such department and powers shall cease if eliminated by vote of either house." Since, we are told, the limitation is built into the original grant, the "law" is not "changed" when Congress abolishes—without any presidential participation—the new department or its functions.

The proponents of the legislative veto respond that, whatever may be its validity with respect to the sort of example I have given, its application to rulemaking involves different considerations, because rulemaking is really "legislative" activity. (This is sometimes softened to "quasi-legislative"—the prefix conveying nothing except a sense that the speaker does not have the courage of his convictions, or does not have the convictions of his adjectives.) There are several replies to this. The first is that the premise is quite simply wrong. Rulemaking is not, as some seem to think, a function dubiously conferred upon the executive only in very recent times because an overly pressed Congress did not have time to attend to all of its own normal business. To the contrary, rulemaking has been an executive function from the beginning. As stated by the 1941 Report of the Attorney General's Committee on Administrative Procedure:

> The promulgation of general regulations by the executive, acting under statutory authority, has been a normal feature of Federal administration ever since the Government was established. The first Congress provided that traders with the Indians should be licensed and bonded to observe "such rules, regulations, and restrictions" as might apply, including "such rules and regulations as the President shall prescribe." In 1796 the President was given authority to establish regulations for estimating the duty upon goods, the cost of which was stated by the importers in depreciated foreign currencies. In 1809 conclusive effect as against shippers and shipowners was given to instructions and regulations of the President authorizing the collectors of customs to refuse permission for loading cargoes, to detain vessels, and to seize goods in the enforcement of the embargo acts.

The fact is that rulemaking is no more "inherently" a legislative function than is the fixing of rates (which used to be done by Congress before the Interstate Commerce Commission was established) or the granting of claims against the government (which used to be done by Congress before the Court of Claims was established). And the fact is that, with very few exceptions, all of the decisions made by the executive branch could be made instead by Congress itself (in which event they would be "legislative") and have become "executive" functions only because Congress has chosen to commit them to the second branch. For example, the Corps of Engineers' decision to construct a bridge of steel rather than wood is as-

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suredly an "executive" decision—but only because Congress has left that decision to the corps instead of itself specifying the construction material. Surely a law directing the erection of a particular steel bridge would not be an "inherently unlegislative" enactment. There is, of course, a category of decision making which should not be delegated to the executive —and indeed, whose delegation would be an unconstitutional abdication of peculiarly "legislative" responsibilities. But the line defining that category has nothing to do with the line between rulemaking and other executive activities. Rulemaking authority, if conferred with adequate standards, is perfectly valid and perfectly executive; and adjudicatory or licensing authority, if conferred without such standards, is an unconstitutional delegation of legislative power.

The second reply to the argument that the distinctively "legislative" character of rulemaking somehow validates the legislative veto in that context is that, even if the premise *were* correct, it has no bearing upon application of the presidential veto provisions of the Constitution. The issue for that purpose is not whether the *executive* is "legislating" in the adoption of rules, but whether the *Congress* is "legislating" in preventing the effect which those rules otherwise would have. As explained earlier, it clearly is. Therefore, the lawmaking provisions of the Constitution apply—which include participation by the President under Article I, section 7.

"But," urge the supporters of the legislative veto, "there *is* participation by the President. It is the President or his subordinates who propose the rules that the Congress may veto. He may in effect veto them by not proposing them. It is simply legislation in reverse!" To begin with, this argument is simply not true with respect to that substantial proportion of all rulemaking conducted by independent regulatory agencies, such as the Federal Trade Commission, the Securities and Exchange Commission, and the Interstate Commerce Commission. With respect to such agencies, the President has no say whatever in whether rules are proposed. More fundamentally, however, the action to which the President's Article I, section 7 veto power attaches is not the agency's issuance of regulations but congressional change of the law—and that change occurs when authorized executive action is invalidated, whether or not Congress asserted in the enabling statute the unilateral power to invalidate. And finally, I simply cannot appreciate the force of the assertion that this manner of proceeding is valid because it is simply the constitutional process *in reverse*. Would we say that an automobile is not defective simply because its four-speed transmission propels it backward rather than forward? Or that a plastic surgeon has done his job well if he produces perfectly regular features at the back of one's head? The point is that the Constitution does not *provide* for legislation in reverse; it provides for legislation in "forward."

The point is that the Constitution does not provide for legislation in reverse; it provides for legislation in "forward."

There is one other argument against the applicability of Article I, section 7, clause 3, which should be met—because, although it is obvious that it is wrong, it is not obvious why it is wrong. This is the argument that the provision could not possibly stand in the way of the *one*-house veto, since by its terms it applies only to action "to which the concurrence of the Senate *and* House of Representatives may be necessary." That argument is obviously wrong because it assumes that the Founding Fathers were careful to preserve the presidential veto as a check upon disguised legislative action by both houses of Congress, but were quite willing to let a single house proceed unchecked (or too dull to provide for that obvious eventuality). The explanation of the apparent incongruity is that, while, in the case of the one-house veto, action by the other house may not "be necessary" under the terms of the applicable statute, it *is* necessary under the terms of the Constitution which, in its very first section, provides that "all legislative powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives." In other words, legislative action taken by means of a one-house veto appears, superficially, to avoid the prohibition of Article I, section 7, clause 3, only because it simultaneously runs afoul of the fundamental requirement of bicamerality.

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The Political Effects

More important, however, than the incompatibility of the legislative veto with the text of the Constitution are what might be termed its unconstitutional effects. Many of those who support application of the device to all rulemaking do so out of genuine commitment to democratic principles, in the belief that it will put an end to the government by bureaucracy which has come to characterize our society. They are profoundly mistaken. For the legislative veto constitutes a ratification and reinforcement, not a repudiation, of the governmental policies that have led to our present state. Its proposed extension to all rulemaking distracts attention from the real problem and offers instead a scapegoat upon which the wrath of the public can be exhausted and the zeal for genuine reform ultimately dissipated.

In the prologue of one of the pending bills, which accurately sets forth the legislation's underlying premises, we are told that the federal agencies have been guilty of a "steady usurpation of quasi-judicial and legislative powers" and of an "often arbitrary exercise of powers granted to the executive branch." And Congress, we are told, "which is closest and most responsive to the needs and will of the citizenry, must reassert on behalf of the people the constitutional right of the people to be secure from the unreasonable and arbitrary actions of the executive branch which result from [such] usurpation." But in truth there has been no pattern of "arbitrary" action; for arbitrariness in this context implies departure from an established standard—and, in the relevant areas, Congress has shrunk from providing standards for many years. Nor has there been "usurpation" of power; for that implies that power has been yielded unwillingly—and Congress has in fact rushed to abdicate for many years, often conferring upon the agencies authority which the incumbent administration itself did not desire. The main culprit, in other words, has not been the agencies but Congress itself.

Consider, for example, the Consumer Product Safety Commission (CPSC), one of the newer agencies which has been the object of considerable public criticism. It was established in 1972 with jurisdiction over virtually every product distributed in commerce and with a rulemaking authority no more specific than to prescribe whatever requirements as to "performance, composition, contents, design, construction, finish, . . . packaging, . . . warnings or instructions" may be "reasonably necessary to prevent or reduce an unreasonable risk of injury associated with such product." Or the Occupational Safety and Health Administration (OSHA), which in 1970 was given rulemaking authority no more definite for most purposes than to require "conditions, or the adoption or use of . . . practices, means, methods, operations, or processes, reasonably necessary or appropriate to provide safe or healthful employment and places of employment." Or consider Title IX of the Education Amendments of 1972, which generally provides that "no person . . . shall, on the basis of sex, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any education program or activity receiving Federal financial assistance"; and which authorizes and directs each agency providing such assistance "to effectuate [such] provisions . . . by issuing rules, regulations, or orders of general applicability." Well, who can oppose the prevention of "unreasonable risks of injury," or the provision of "safe and healthful places of employment," or the elimination of "sex discrimination"? We can all embrace these platitudes. But what do they *mean?* Does the prevention of "unreasonable risks of injury" from children's pajamas require that they be utterly fireproof, at an enormous increase in consumer cost? Does the provision of a "safe place of employment" require split toilet seats, or the relocation of all fire extinguishers so that they are precisely X inches from the floor? And does the elimination of "sex discrimination" require that all-boy or all-girl athletic teams be abolished? These are the sorts of issues that lay beneath the platitudes when these pieces of legislation were passed, and Congress *chose* to leave them to the agencies (and per-

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haps ultimately the courts) to resolve.

Congress has been behaving in this fashion for much of the past fifty years, assigning to the agencies vast and important decision-making authority—not only in rulemaking, but in adjudication as well—which does not require merely the application of scientific analysis, or logic, or deductive reasoning, but involves essentially political judgments, as to which there are no "right" or "wrong" answers. This may work well enough in those areas where a substantial political consensus exists. And even in the absence of such consensus, it may work well enough when the total number of programs is small enough that the President and Congress can, realistically, keep an eye upon them and correct those political judgments that are simply out of accord with the people's desires. What has happened since the 1960s, however, is that what may be termed "consensusless" programs, such as those administered by CPSC, OSHA and, for another example, the Environmental Protection Agency, have increased enormously in number and are now well beyond monitoring by our political representatives, either in the White House or on Capitol Hill.

Even this analysis omits an aggravating element: With respect to many of the important political judgments that it has delegated, Congress would not wish to monitor even if it *could* do so. I refer to those judgments that were delegated in the first place simply because they were "too hot to handle." The sex discrimination prohibition is a good example. It was apparent when that law was passed that its concrete application would arouse heated controversy over precisely such issues as all-male sports, unisex dorms, and even unisex toilets. Was it not more appealing for Congress to take the high road, winning approval from all sides by being against "sex discrimination"—and leaving to the agencies the inevitable alienation of one or another constituency which accompanies the act of giving that term content? And will not the same self-protective motivation which induced Congress to abstain from more specific legislation in the first place also induce it to abstain from revising agency action later on?

But, to come to the point, what does all this have to do with the legislative veto? It suggests, I think, that there is nothing—absolutely nothing—the legislative veto can do to solve the basic problem. There are only two powers which the legislative veto confers upon Congess that could not be exercised through the ordinary legislative process. The first of these is the ability to avoid the presidential veto. Leaving aside for the moment the fact that that is unconstitutional, is it at all *relevant* to the problem of controlling the agencies? Has the difficulty really been that Congress has tried repeatedly to reverse the results of agency rulemaking through legislation but has been stymied by the President? I am not aware of a single instance. And the second and last distinctive power conferred by the legislative veto—if it is a one-house veto—is the ability of both the House and the Senate separately to overturn rules without the concurrence of the other body. But again, has *this* been the problem? Are the files of Congress filled with dead bills overturning agency rulemaking that have been passed by one house only to be spurned by the other? Not to my knowledge. The problem has been, quite simply, that *both* houses have had neither the time nor the inclination to review agency rulemaking, just as they have had neither the time nor the inclination to write more detailed legislation in the first place, which would render the most significant rulemaking unnecessary. The proof of this thesis is readily available. All rulemaking of HEW's Office of Education has been subject to legislative veto since 1974. Has that agency become the model of responsiveness after which the rest of the government should now be patterned? Hardly—because the legislative veto has had no appreciable effect in ensuring democratic control.

Instead of government by one bureaucracy, we will have government by two—hardly a step towards more democratic government.

In fact the legislative veto will be worse than ineffective in solving the problem of government by bureaucracy. It will ultimately both increase the problem and breed other threats to democratic self-government. The one scientific study of the effect of existing legislative veto provisions that I am aware of—conducted by

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Professors Harold Bruff and Ernest Gellhorn for the Administrative Conference of the United States—concluded that "much settlement of policy occurred in behind-the-scenes negotiations between the staffs of the [relevant congressional] committees and the agencies." Of course that would be the result! Our elected representatives clearly will not have time to review the torrent of regulations pouring forth every month, so that task will be entrusted to a shadow rulemaking bureaucracy on Capitol Hill. That will become the real body which agency bureaucrats have to please in order to forestall congressional veto. Instead of government by one bureaucracy, we will have government by two—hardly a step towards more democratic government.

Another deleterious effect of the legitimation of the legislative veto will be an increase in that very practice of congressional delegation of vague and standardless rulemaking authority which has placed us in our current predicament. That is to say, the delusion that it will be able to control the agencies through the legislative veto will render Congress all the more ready to continue and expand the transfer of basic policy decisions to the agencies. It is significant in this regard that some of the most prominent examples of legislative vetoes enacted in the past were proposed by the executive branch itself—to induce the congressional transfer of power which would otherwise not have been accorded.

And finally, the legitimation of the legislative veto will enable continuation and expansion of the recent practice of adopting major measures by a process which preserves congressional control while relieving the people's representatives of the embarrassment of voting. This process was exemplified by the Executive Salary Cost-of-Living Adjustment Act, which in February of 1977 enabled the members of Congress (together with high-level executive and judicial officials) to obtain a 30 percent pay raise without ever having to stand up and vote for it. This was accomplished by the process of giving the President the power to prescribe salaries (a form of rulemaking)—subject, however, to congressional veto. The latter feature was of course essential to the scheme, since Congress would not have been willing to accord the President authority over salaries without retaining such a whip-hand. What happened in 1977 was that a President who had already lost his bid for reelection (and therefore had little political capital to lose) proposed the massive increase, and Congress did not say "nay." There was an angry public outcry, as there well should have been. Not so much, I think, because the increase was thought to be undeserved, but because of the fashion in which it had been accomplished. Such legislation by inaction is not the system our Constitution envisions. If Congress is willing to commit a matter to the executive, well and good; but if Congress wants to retain control of the matter, and thereby admits that it has not completed its legislative function—then it must act by voting, not by simply standing silent.

A similar motivation has prompted the adoption of legislative veto schemes for executive reorganization. Reorganization is terribly difficult if Congress must affirmatively vote for it. The interest group pressures which must be withstood to abolish or even restructure an agency are enormous. But that simply suggests that the issue is a very important one; and congressional subjection to those pressures, before standing up to be counted in an honest-to-goodness vote, is the very essence of the democratic process! By enabling Congress to have its way —that is, effectively to control the outcome— without affirmatively accepting responsibility in a record vote, the legislative veto is an egregious subversion of the democratic process.

Over the years, most of the criticism of the legislative veto has originated in the executive branch, and thus has focused on the propensity

[The legislative veto has been criticized for its propensity] to alter the constitutional balance . . . between the first and second branches of government. In my view, that is much less fearful than its propensity to alter the balance . . . between those two branches . . . and the people.

of the device to alter the constitutional balance of power between the first and second branches of government. In my view, that is much less fearful than its propensity to alter the balance of power between those two branches combined and the people. Its utility in ensuring

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agency responsiveness to the people is negligible; but it is an excellent mechanism for enabling the President and the Congress to facilitate the passage of unpopular laws by eliminating the congressional burden of having to vote for them.

I am in the greatest sympathy with the objective of revivifying what appears to be a failing system of self-government in the United States. The legislative veto, however, is a "quick fix" which simply will not work. The same can be said for Congress's frantic search for new procedural constraints upon agency action. Better procedures are of course always desirable. But the *main* illness from which we suffer is not that the agencies are acting hastily, or unintelligently, or without adequate information —nor even that they are reaching the "wrong" decisions, for most of these matters that concern us have no objective "right" or "wrong." The main problem is that the agencies have been assigned too many tasks requiring judgments that are of an essentially political nature and that ought to be made by our elected representatives. And the only remedy, if we really want a remedy, is to take some of those tasks away and to perform them instead by legislation, or not to perform them at all.

To OFFER the legislative veto to our citizens as a cure for the very real alienation from government that now besets them—for their feeling of "being governed" rather than governing themselves—is to delude them. Instead, the members of Congress should tell them the hard facts, perhaps in a letter to constituents that reads something like this:

Fellow Citizens:

There is abroad in our land the feeling that we no longer control our government, but it controls us, through thousands of law-making functionaries in every field of life who are effectively beyond popular control. That feeling, I am sorry to tell you, is well founded. And the cause is quite simply that your Congress has over the years delegated so many policy judgments of the sort once made by your elected representatives to the executive agencies that by now neither the Congress nor the President can realistically monitor or supervise the results.

The system is overloaded. We are now at the point at which each major new program entails an overall diminution of democratic control.

We in Congress have done this not maliciously but with the best of intention. We have wanted to give all of you a clean environment, a safe working place, safe consumer products, protection from deceptive merchandizing—and many other protections which were in earlier years the responsibility of elected bodies in your cities, counties, and states. You have evidently approved what we have done, since you have continued to elect us on the basis of these programs.

But the time has come to tell you that all these benefits cannot be provided at the federal level and still be provided in a democratic fashion. There are simply too many important policy judgments to be made. Your elected President and your elected members of Congress cannot possibly make them all or even keep track of them all—and it is useless any longer to pretend that we can.

You must face the unhappy fact that democratic government implies—at least at any single level—limited government. You cannot realistically continue to demand from us in Washington the constant stream of new programs we have become accustomed to providing and at the same time complain that these programs are governed, not merely in their details but in many of their basic directions, by individuals whom you have never had the chance to vote in or out of office. The system is overloaded. We are now at the point at which each major new program entails an overall diminution of democratic control. You must keep this inevitable trade-off in mind.

Instead of writing this letter, I might have berated an unresponsive bureaucracy, or proposed encumbering the agencies with new procedures, or supported devices that give the appearance of "no-nonsense" congressional control. But the truth is that the bureaucracy is not unresponsive, only unelected; that procedures are no substitute for the ballot box; and that congressional control is no longer possible.

I thought you would want to know the truth. ■

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Who Will Adopt The Orphan Drugs?

Louis Lasagna

LET US SUPPOSE a massive radiation leak occurs somewhere in the United States, creating an urgent need for an effective antidote for plutonium poisoning. The government has, of course, long been seeking such an antidote and comes riding to the rescue in the nick of time.

This is fiction. In the real world, not only has our government's commitment to searching for a plutonium antidote waned in recent years but a promising antidote has never been made available because of excessive regulatory demands.

There is a simple chemical relative of EDTA (a "chelating" or "leeching" agent used to treat lead poisoning) that is the most effective agent known for reducing plutonium in the body if given by intravenous injection promptly after exposure to radiation. Needless to say, health officers in the few laboratories where plutonium accidents might occur wanted to stock this drug in case of emergency. Moreover, the scientists in the company that discovered it persuaded management that it had a moral obligation to make the material available. The scientists also foresaw diagnostic utility for the drug in two other uncommon, and hence commercially unattractive, clinical situations: low-level lead intoxication and iron overload. In these instances, a single modest dose of the drug would suffice.

So far so good. But now enter the federal government in the form of the Food and Drug Administration (FDA).

The FDA demanded long-term toxicity tests at three different dose levels in each of two animal species before the drug could be approved (though the drug had already been given to animals in large intravenous doses daily for a month, without harm). In other words, the FDA wanted a full-scale project typical of that required to market an ordinary drug—a project of the sort that costs upwards of $50 million these days. But what was involved here was a drug whose market potential was, to put it mildly, negligible. In the end, the company decided that while it was willing to manufacture a "public service" drug on which it would lose money, it did not feel obliged to fight for the privilege. The project was dropped.

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One might think this to be an isolated case. Not so. It is merely another in a long series of "orphan drug" cases—where an agent with exciting potential for treating human disease is blocked through lack of interest on the part of the people and institutions whose commitment is necessary for bringing it to market. The reasons for "orphanization" are many. But one point is central to them all—orphan drugs do not fit the mold in which the FDA's usual regulatory process is cast or the mold of pharmaceutical company thought that typically goes with it.

Carnitine

Another orphan, carnitine, illustrates aspects of this problem that are in some ways quite different from those of the EDTA analogue.

In 1964, a French pharmaceutical firm (Labaz) asked Pfizer, Incorporated, if it had any interest in the possible antihyperthyroid activity of carnitine, a naturally occurring biological substance present in most mammalian tissue, with relatively high concentrations in the heart. Pfizer asked Stephen De Felice, a young doctor working in its laboratories, to check it out clinically. To his surprise, De Felice found that three classically hyperthyroid patients, when given carnitine, became free of their symptoms within a week, with their abnormally rapid pulse rates dropping toward normal. Moreover, during the course of these experiments, one patient reported that his angina pectoris was better for the first time in years. De Felice recalled this observation later, after a thorough reading of the world literature on carnitine, and postulated that carnitine could provide needed metabolic fuel to a heart with a partially blocked blood supply. He arrived at this idea quickly enough, but it took the next thirteen years to test it successfully in humans.

First, through cardiovascular experiments in dogs, it was learned that carnitine protected the heart against coronary artery spasm or occlusion. Next, the drug was found to protect both dogs and guinea pigs against the toxic effects of diphtheria toxin and, in the case of anesthetized dogs and pigs, to stimulate heart function and to offset the cardiodepressant effects of several drugs. Also it could protect dogs against the lethal shock caused by toxins produced by bacteria. Most amazing, in some respects, was the ability of carnitine to protect animals against the severe cardiac toxicity of two powerful anticancer drugs without impairing the antitumor activity of those drugs.

Not unreasonably, De Felice expected that academic and industrial experts would be as excited as he was. But not so. The findings were almost too good to be true, and there was no precedent for this kind of drug. Furthermore, most of the data were unpublished and hence could be said not to have passed the critical scrutiny of editorial referees. The data were unpublished for a good reason—the absence of a secure patent position. One cannot patent a natural substance as such, and a "use" patent was not really sufficient in this case because of the possibility that carnitine would have numerous uses. Suppose, for example, one had a valid patent for its efficacy in heart disease and carnitine turned out to be good for headache or something else? How could one guarantee to an interested company that some johnny-come-lately competitor would not make off with the biggest market?

But De Felice was not to be denied. In 1969, having left Pfizer, he began clinical trials in Costa Rica and Yugoslavia with the aid of a modest $15,000 grant from a German company. The initial results were disappointing. Indeed, had it not been for a single patient in shock (stemming from bacterial infection) whose blood pressure responded after carnitine, human studies might have stopped. But because of this case, two University of Wisconsin scientists recommended that carnitine be tried in coronary patients subjected to electrical stimulation of the heart. To De Felice's surprise, the study showed that carnitine allowed diseased human hearts to respond better and longer to such "atrial pacing." These conclusions were then confirmed through tests on patients in whom angina would be precipitated by exertion on a bicycle or treadmill.

Meanwhile, back at the front office, company after company either refused to support the research or dropped out after temporary involvement. Ultimately, De Felice found a sponsor in the person of Dr. Claudio Cavazza, the young and dynamic president of the Italian drug firm, Sigma-Tau. It took all of one hour for Cavazza to see the scientific and commercial promise in carnitine. Without delay, a new U.S.

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company was formed to pursue marketing here, while Sigma-Tau proceeded with European sales.

The paradox is that carnitine could conceivably turn out to be one of the most important drugs of recent times. Not only is there a lot of heart disease in this world, but the drug has possibilities for everything from muscular dystrophy and cancer chemotherapy to intravenous feeding. Hardly a month goes by without a new scientific communication about this interesting material. And, best of all, it is remarkably nontoxic.

By now De Felice has spent $60,000 of his own money on carnitine—perhaps not much as medicinal drug development costs go, but enough to discourage most solo entrepreneurs. It would be a lovely twist of fate if he were to reap handsome financial rewards from a drug rejected by thirty-two U.S. and international companies. The rejections were, to be sure, mostly understandable. Until now, carnitine has been a victim of its natural origins, which make it unpatentable, and its unorthodox and varied effects, which mean that there is no precedent for its many actions and therefore little chance for it to enjoy smooth sailing at the FDA.

Dopamine, Triethylene Tetramine, and L-5HTP

A turn of events giving De Felice large profits would not be without precedent. Dopamine, another naturally occurring substance, was investigated for years by Dr. Leon Goldberg, who first became interested in cardioactive drugs as a graduate student in 1949–1952. Later, while at the National Institutes of Health, he fortuitously discovered that dopamine had highly desirable characteristics for treating heart failure. Results from dog experiments were soon corroborated in human tests, as four critically ill patients improved on dopamine after failing to respond to digitalis and diuretics. Moreover, the experiments in man showed something that the dog experiments had not: a beneficial and unique effect on kidney blood flow. This finding, whose clinical importance is very great, suggested dopamine's use in the treatment of shock, where it again proved beneficial.

At this point, even though it was already clear from *human* studies that dopamine was at least as safe as marketed drugs for treatment of shock, the FDA demanded animal toxicity data—which meant tests that Goldberg could not afford to carry out. So began the search for a commercial sponsor. In 1966, the total market for drugs used in treating shock was $2.5 million. To perform the studies needed to seek approval for the marketing of a drug cost between $2 and $3 million at that time. Since dopamine was a natural substance and therefore unpatentable, commercial interest was limited. In addition, the raw material was expensive to make. Nevertheless, Goldberg finally found an interested sponsor in Arnar-Stone, a modest specialty drug firm located in the Midwest. After seven years of frustration, the drug was approved by the FDA in 1974, some sixteen months after filing. In 1978, annual sales of dopamine were over $15 million. Not bad for an adopted orphan!

While the examples of carnitine and dopamine come from the cardiovascular field, orphan drugs are by no means restricted to any one area of therapeutics. The next two examples have to do with the central nervous system.

The first is triethylene tetramine, discovered by one of Britain's most distinguished neurologists, Dr. J. M. Walshe of Cambridge University. In 1950 Walshe began some experiments that ultimately led him to suggest the use of penicillamine in the treatment of patients with a rare ailment called Wilson's Disease. These patients lack the genes necessary to keep body stores of copper below the toxic level. Excess copper is deposited mostly in the liver and brain, where it leads to organ failure and death. Penicillamine has actions similar to those of EDTA, being able to leech copper from the body. In 1956 Walshe showed it to be virtually a miracle drug for sufferers from Wilson's Disease, and in short order the drug was approved.

But that was twenty-five years ago. Since then Walshe has learned that it is no longer so easy to market a drug for a rare disease. His interest in finding satisfactory treatments for Wilson's Disease had continued because penicillamine, while lifesaving, turned out to have side effects that can be lethal in those who are sensitive. In 1972 Walshe found a better and safer drug—triethylene tetramine, which works in patients who have failed on, or shown severe toxic reactions to, penicillamine. He now has

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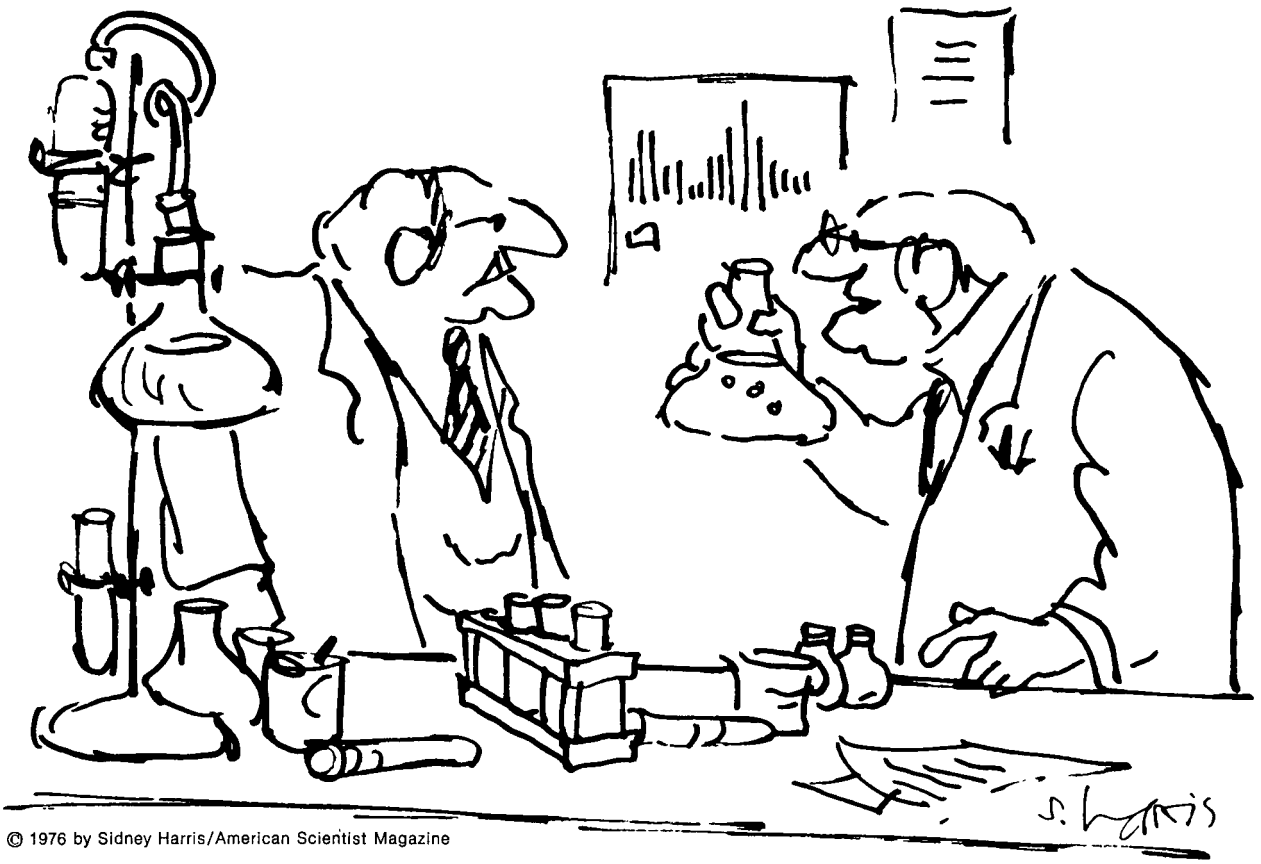

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"IT MAY VERY WELL BRING ABOUT IMMORTALITY, BUT IT WILL TAKE FOREVER TO TEST IT."

nineteen patients whose lives it has saved. This drug, like penicillamine, can be toxic, and making it in the pure form (which seems to have little toxicity) is a bit tricky. And unfortunately, no firm has come forth to sponsor it. This is not surprising, given the litigiousness of society today, the tendency for courts to hold manufacturers liable for any and all harm from drugs (especially in the United Kingdom), and the fact that triethylene tetramine is needed by only a handful of patients.

L-5-hydroxytryptophan (L-5HTP) is another neurological orphan drug. Its main proponent is Dr. Melvin van Woert, a neurologist at Mt. Sinai School of Medicine who was involved in the pioneer work that led to the use of levodopa (L-dopa) in Parkinsonism. Just as L-dopa is the precursor of dopamine, a natural transmitter of impulses in the brain, so L-5HTP is a precursor of serotonin, another neurotransmitter. In the wake of L-dopa's success, van Woert began trying L-5HTP for various other neurological disorders that, like Parkinsonism, were characterized by abnormal movements of the body. He found that L-5HTP (plus an enzyme inhibitor) produced dramatic improvement with minimal side effects in patients with myoclonus, a disease that causes abrupt involuntary jerky muscle movements. These jerks range from tiny twitches of a finger to movements so strong that the patient is flung to the floor, or objects held in the hand are hurled

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across the room. Noise, light, or even attempts to sit up or hold a fork can trigger myoclonic movements.

There are many causes of myoclonus, but some cases are postulated to be due to a brain deficiency of serotonin. It is now generally agreed that certain patients with myoclonus respond to treatment with L-5HTP, sometimes being transformed from bed-ridden invalidism to the point where they can walk and take care of themselves.

There is, however, a problem—the drug costs about $135 per month per patient. Having finally found a useful remedy, van Woert now has to fight for the funds needed to keep his patients from relapsing to their former state. Grants from the National Institutes of Health (NIH), several drug firms, and private donors have proved to be only stopgap measures. For the last two years, a National Myoclonus Foundation has helped raise additional funds.

The difficulty is that some of the common sources for drug-cost reimbursement are ruled out by a perverse twist of FDA regulation. Until a drug is approved for marketing, it is an "investigational drug" and patients cannot be reimbursed by Medicaid, Medicare, or private insurance companies. But no company is likely to sponsor L-5HTP for marketing because the number of patients needing it is so small. Requests for help in solving this dilemma have gone to Senators Kennedy, Magnuson, and Javits, and to Representatives Holtzman and Ottinger, all to no avail, while letters to Ralph Nader and his consumerist associate Dr. Sydney Wolfe have not been answered. And the several pharmaceutical companies that have expressed a willingness to market the drug are interested only if the development costs are likely to be modest.

There the matter sits. So far, various temporary expedients have sufficed to purchase just enough bulk from the manufacturer to allow private capsuling by van Woert. But it is a hell of a way to go about treating sick people.

Reasons for Orphanization

It is hard to know how many orphan drugs there are. The ones that have come to public scrutiny are probably only the tip of the iceberg. The Center for Disease Control in Atlanta, for instance, has had to procure, stock, and distribute about forty biologic products for treating everything from botulism to snake bites and for preventing death from such varied diseases as encephalitis and tularemia; it also makes available eleven antiparasitic drugs. Most of these materials have never been licensed for marketing.

There are, as I have said, different reasons for the existence of drug orphans. One is the estimated size of the potential market. No matter how low the cost of development, it is difficult for a company to justify committing funds to a product that will never make any money or even cover its costs. And of course development costs are rarely low. Indeed these costs, which have risen dramatically in the wake of the 1962 Amendments to the Food, Drug, and Cosmetic Act, have become a major deterrent to the development of all drugs, but especially the orphans. In the pre-1962 days, drug companies could provide "prestige" or "public service" drugs without making an excessive corporate investment. Today, it takes them, on average, $54 million and eight years of clinical work to bring a new drug to the U.S. market, even leaving aside the legal liability risks for the toxic effects that all drugs can produce. The problem for the public-spirited firm is that resources spent on "losers"—on the low-volume unprofitable drug—cannot be devoted to research on potential big "winners."

It is not too strong to say that the FDA never does anything that actually cuts the costs of drug development. Rather, each new regulatory fiat ups the ante.

Behind the excessive costs are the ever-increasing demands of the FDA's Bureau of Drugs. It is not too strong to say that the FDA never does anything that actually cuts the costs of drug development. Rather, each new regulatory fiat ups the ante.

Also, as noted, some orphan drugs are not patentable as drugs. The subsequent lack of exclusivity (or the fear of that lack) is a powerful deterrent to development, "use" patents being less attractive to firms than patents for chemical entities, and less enforceable.

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But there is also a certain lack of imagination on industry's part. Dopamine testifies to that lack, and so, I suspect, will carnitine. Some disgruntled scientists have begun to refer cynically to the "NIH syndrome"—meaning not the National Institutes of Health, but "not invented here." If a company's scientists did not develop a particular idea or seek out a particular product on their own, it is not worth considering.

New Directions

Although few people are eager for the government to get directly into the business of producing and selling pharmaceutical drugs, we are beginning to hear demands for a degree of socialization of drug manufacture or for "orders" from government to "force" private industry to market orphan drugs. Senator Kennedy has on several occasions introduced legislation that would establish a National Center for Clinical Pharmacology, one of whose functions would be the study and development of orphan drugs. It is by no means clear from this proposal how this responsibility would be met.

Can anything be done to get around regulatory and industrial apathy while forestalling further governmental intervention in the drug industry? Back in the 1950s, the National Cancer Institute began to attack the problem of orphan drugs in its own area. Its initial approach was to contract with drug firms to stimulate badly needed cancer chemotherapy research, and the institute continues to work closely with industry at every level of development, from animal tests to clinical trials. Hundreds of thousands of synthetic and natural products have been screened. The results have been salutary, and patent problems with drugs discovered by such joint measures have been minimal. There is a similar program, at least in theory, at the National Institute of Neurological and Communicative Disorders and Stroke for the development of antiepilepsy drugs.

The FDA, for its part, could adopt less rigid rules for drugs of limited commercial value than for drugs of more general use. Whether it would need legislation to do so is largely moot. In the past this agency has been expansive in its interpretation of the law and the legislative history whenever it has wanted to do something, and restrictive only when it has been reluctant to act. Be that as it may, the FDA is now suggesting, in proposals currently before Congress (S. 1045 and S. 1075), new approaches for orphan-type drugs that could in theory facilitate research and development. The effort enjoys the moral support of the agency's advisory committee on orphan drugs, whose recent report, though too general to give specific guidance, at least agrees that the problem deserves attention.

Special patent protection or market exclusivity for the private sector for a period of years would also be a help. So would tax incentives—particularly incentives to encourage innovation by small firms. It is paradoxical that the 1962 drug amendments, stimulated in part by Senator Estes Kefauver's antipathy to monopoly and concern for small business, brought about the high drug-development costs that have helped to destroy small pharmaceutical firms. Perhaps this trend could be reversed by passing legislation that allowed the formation of venture development firms enjoying favorable tax treatment. Small firms with limited staffs could, it has been argued, find it profitable to take a drug from the point of discovery through marketing approval, and then to license it to an existing drug firm that had distribution and marketing capabilities. Capital might be solicited the way oil exploration firms obtain funds for drilling costs. Such venture development firms could be associated with universities—following the model already being used successfully in Kansas, South Carolina, and Wisconsin.

IT IS DIFFICULT to be optimistic about orphan drugs, despite occasional happy endings to past stories. The problem calls for imagination and flexibility—qualities for which neither regulators nor regulated industries are notorious. Yet science has never been so poised for progress as at this moment. There will be breakthroughs. And when they come, they will quite probably be as different from today's drugs—our penicillins and prednisones—as today's drugs are from the calomel and cinchona of the last century. Rather like carnitine, perhaps. It would be a pity if they came into the world as orphans, never to be adopted. ■

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POLITICS AND POLARITY
The Limits of OSHA Reform

Michael Levin

SINCE ITS BIRTH in 1970, the Occupational Safety and Health Administration (OSHA) has been in the forefront of the growing debate over the costs, benefits, and proper thrust of government regulation. Its supporters soon accused it of not doing enough to protect workers and began to call for more regulations ("standards"), more inspectors, more citations and fines. Its detractors indicted it for capricious and ineffective enforcement, gross ignorance of real-world industrial operations, zealous policing of requirements that bore no relation to genuine job hazards, and a basic lawlessness that caught even employers with exemplary safety records in a tangle of conflicting rules. In 1976, horror stories about OSHA became a staple of the presidential primaries, with President Ford, for example, telling a cheering group of New Hampshire businessmen that he understood their desire to "throw OSHA in the ocean." In July 1977 President Carter endorsed OSHA's mission but said the agency itself was "going to extremes." The next month he created an Interagency Task Force to assess OSHA and explore ways to supplement direct regulation.

Meanwhile Congress was lumbering in similar directions. From 1973 through 1976 over 100 oversight hearings were held before eight different House and Senate committees. The pro-OSHA forces beat back a number of direct attempts to abolish or restrict the agency. But in 1975 Congress began to pass appropriations riders to relieve employers of various paperwork burdens and procedural harassments. A rider adopted in 1976 barred the use of agency funds to inspect small agricultural employers or to fine any employer with fewer than eleven nonserious violations per inspection. And lightning nearly struck in 1978 when the Senate passed a Small Business Act amendment, sponsored by Senator Dewey Bartlett (Republican, Oklahoma), that might have exempted 2.8 million small establishments, almost 70 percent of the worksites covered by OSHA. The amendment was ultimately deleted in the last days of the ninety-fifth Congress. But it left a shaken agency, whose congressional allies were beginning to tire of fights in the trenches with only disapproving mail from home.

Since then the heat in OSHA's kitchen has declined a bit. Under its fourth administrator, Dr. Eula Bingham, the agency has created at least an impression of movement in response to calls for reform. It has deleted about 1,000 unnecessary standards—more accurately, subsections and clauses of standards—including requirements for split toilet seats, coat hooks on lavatory doors, and the maximum number of knotholes in wooden ladders. It has tried to make on-site compliance advice more available to employers. It has shifted inspections to large worksites in high-hazard industries and at-

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tempted to focus on serious dangers rather than trivial ones. It has funded university-based centers to educate workers and managers in hazard recognition and safe work practices. And it has launched an ambitious program to produce several major standards a year in the long-neglected area of occupational health—a program that has generated salutes from unions and public interest groups, along with concern from business, the academy, and the White House as the front-end costs of these standards have begun to be realized.

OSHA: The Picture of Dorian Gray

Yet the call for reform is not easy to answer, since it masks the sharply different goals held by the agency's opposed publics. In many other regulatory areas, reform is made difficult by the shifting and unpredictable nature of such interest group reaction. Here the difficulty is quite the opposite—the clear, almost petrified, polarization of management and labor.

Unlike the Environmental Protection Agency (EPA) or the Consumer Product Safety Commission (CPSC), OSHA deals with what goes on in a plant rather than what comes out of it—with practices that place the agency smack in the middle of collective bargaining. Whether or not a worksite is unionized, each OSHA standard or inspection threatens to tip the balance between management and labor, to destabilize in-plant relations. Many employers believe that this danger is acute because workers or unions can request an inspection at will. Where no-strike clauses bar a work stoppage over bread-and-butter issues, inspection requests are a tempting way to start or get the most out of labor disputes. And they offer a handy tool for candidates for union office to project leadership and concern.

Whatever one thinks of such tactics, they spring from tensions that must be recognized if the agency's actions are to be understood. In this area, as with collective bargaining over wages or pensions, there will never be a natural stopping point at which unions admit benefits are sufficient (safety and health protection is adequate) and employers agree costs are reasonable. There will only be more rhetoric about union arrogance on the one hand and management callousness on the other—with both sides looking to the next clash down the line.

. . . the whole bitter burden of U.S. labor history—the mutual distrust, management's desire to run its business with minimal interference, labor's belief that employers cannot be trusted to do the "right thing" . . . has been loaded on OSHA.

Thus the whole bitter burden of U.S. labor history—the mutual distrust, management's desire to run its business with minimal interference, labor's belief that employers cannot be trusted to do the "right thing" without a gun at their heads—has been loaded on OSHA. That history is the reason for OSHA's being placed in the Labor Department, where labor's influence would be ensured. It is the reason for OSHA's insistence on additional inspectors, higher fines, more detailed standards, more hard-nosed enforcement—goals that coincide with labor's desire for specifications that job stewards can police. It is the reason for OSHA politics that require an extended obeisance to the unions for every departure from past practice. It is why many employers believe their problems with OSHA may be listened to, but not heard.

With all this in it, the OSHA pot may boil over any time. The agency's "internal reforms" have been largely superficial; its basic approach remains unchanged. Despite the defects of detailed standards—their limited subject matter and slow development, their tendencies to freeze technology, jam different workplaces into the same mold, affect small firms more heavily, and draw funds from other efforts that might control hazards better—OSHA is increasingly committed to such standards. Though it will never have enough inspectors to cover its universe of 5 million worksites and 65 million workers, it continues to rely on direct enforcement to make the protection of those standards real. Its field inspectors still visit small firms over half the time, even though these firms account for less than one-fifth of all serious injuries. Moreover, the inspectors still have strong motives to cite long lists of violations as evidence they are doing a "good job." It is unclear how they will rationally enforce dozens of complex health rules when they can barely cope with successive emergencies involving

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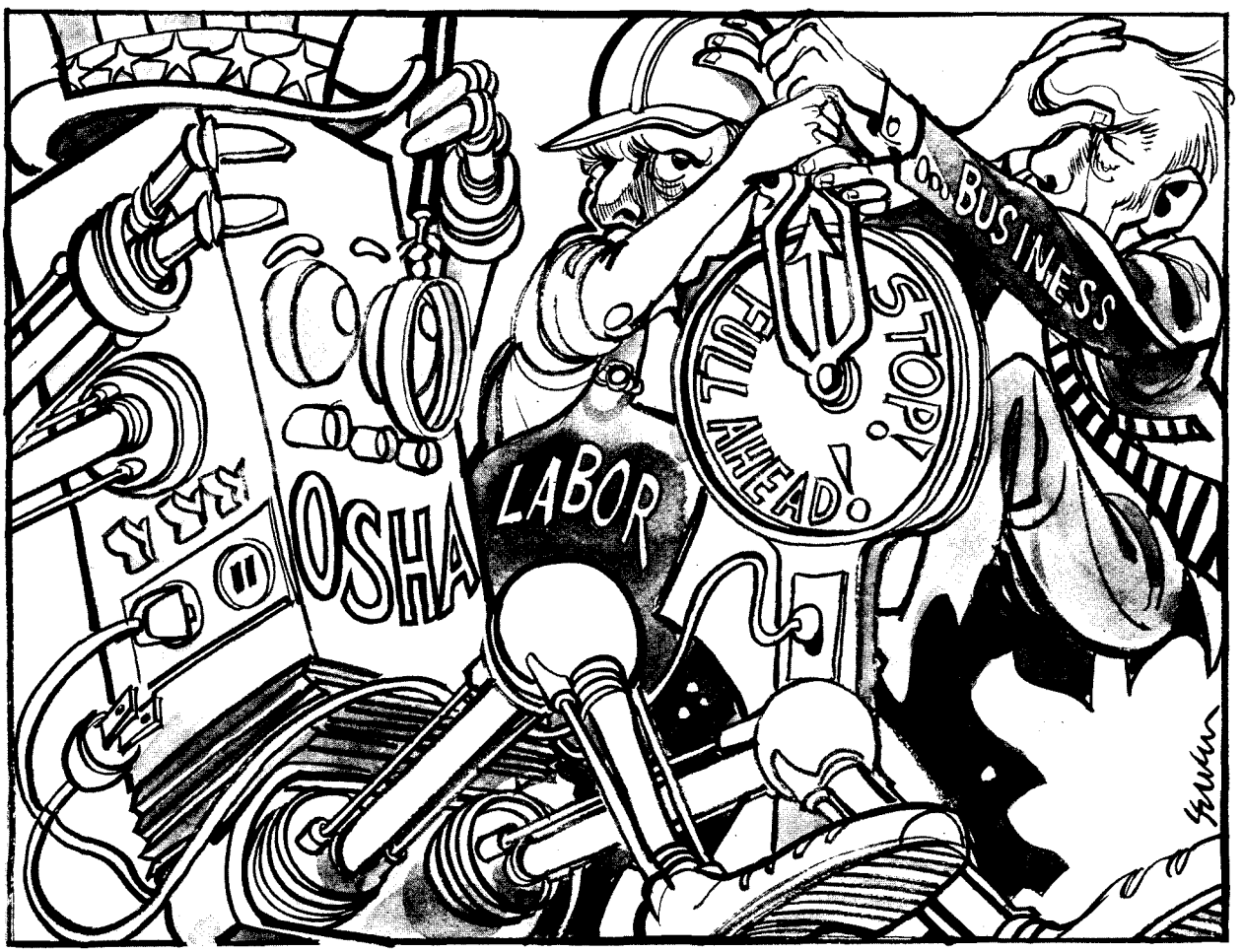
grain elevators, concrete construction, or newly revealed chemical hazards. And it is equally unclear that sending them to large plants in high-hazard industries will measurably improve worker protection, since many large plants already have below-average injury rates.

What is clear is that OSHA must show substantial gains in the safety area—where outcome measurement is at least possible—if the credibility of its health campaign is to be preserved. But available safety data are equivocal, if not perverse. During OSHA's 1972–1975 Target Industries Program, for example, the severity of serious injuries in all five intensively inspected industries actually increased. From 1972 through 1977, the country's overall serious-injury rate went up 15 percent and the *severity* of those injuries rose nearly 30 percent. The most thorough study to date found not only that OSHA had reduced job-related injuries by no more than 5 percent, but that current standards were likely to affect only 25 percent of such injuries even if ideally enforced. Between 1976 and 1977, the occupational fatality rate doubled for firms with under twenty workers, and rose 20 percent for industry as a whole. Finally, between 1972 and 1976, workers' compensation expenses also doubled—rising from $4.9 billion to between $8.5 and $11 billion—while U.S. industry's real capital investment for job safety and health held steady at about $2.5 billion a year. Such figures suggest that OSHA may be redirecting business safety expenditures more than it raises them. But they also suggest that employers are finding it increasingly attractive to pay for injuries when they occur instead of investing in prevention.

These numbers do not tell us whether OSHA's program has "worked," since it is difficult to determine what the injury rates would have been without it. Fatalities are too rare to be reliable indices of agency performance, at least over the short run. And many data are not controlled for exogenous factors—such as busi-



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ness upturns and changes in the composition of the work force—which can also raise rates.

But the numbers have bolstered a widespread perception of ineffectiveness that is more abiding than the effect of any "technical" explanations. The fact remains that to attain political legitimacy, OSHA needs to point to significant results and has not yet been able to do so. The question is whether it will keep accumulating citations and penalties that do not demonstrably improve worker protection, or begin moving beyond direct enforcement to achieve the larger goal. For the moment the agency is a kind of Picture of Dorian Gray—it appears pure and shining to its supporters, but seamed with warts to those who view it in a different light.

Present at the Creation

How did OSHA get into this fix, and what are the prospects for moving the real agency towards the ideal picture?

When Richard Nixon proposed a new job safety and health program in 1969 he could scarcely have thought he was creating what has come to be seen as the regulatory straw that broke the camel's back. His aim was to consolidate his New Majority by "doing something" for labor—a goal later reinforced by desire to reward the hard-hats who supported his policies on Southeast Asia. The reward was to be a statute that could be painted as a major effort, a comprehensive bill.

The unions had long sought such a bill, having found job safety difficult to achieve through collective bargaining. For one thing, many workers exposed to visibly severe occupational hazards—especially those in low-pay, entry-level jobs—had little political power within the unions. As a result, few locals were willing to strike over safety issues. For another thing, the presidents of the international unions were tired of being blamed for bargaining away safety and were worried about being ambushed on the issue by their membership's left. A job safety bill, which would remove safety from the bargaining table by making it mandatory, seemed the perfect way to get this monkey off their backs. Besides, that bill would be referred to the labor committees of the Congress—committees that the unions, not the administration, tended to dominate.

To pass a "big bill," however, it was necessary to have a crisis that would generate support for the sustained congressional effort required. Thus it was stated again and again that job-related accidents were causing 15,000 deaths and 2.2 million disabling injuries each year, resulting in an annual loss of $1.5 billion in wages and $8 billion to the gross national product; that the country's serious-injury frequency was 20 percent higher than in 1958; and that job-based health hazards were producing as many as 100,000 deaths and 400,000 new cases of occupational disease every twelve months. Witnesses duly noted that industrial hazards had claimed more American lives since 1965 than Vietnam. The specter of ancient and modern workplace poisons was invoked, and their scope and insidious nature documented in four fat volumes of hearings.

Two efforts were made to provide some perspective for this debate. A group of conservative congressmen asserted that short-term trends were misleading because job-related deaths and injuries had peaked around 1937 and declined steadily since. This argued that there was no crisis—that job safety was a serious problem but states and employers were doing well enough to merit a helping hand rather than the kick in the teeth that sudden federalization would represent. At the same time a liberal congressman, Philip Burton (Democrat, California), questioned whether federal standards and enforcement would produce much change by themselves. Burton noted that present incentives favored the status quo, since the low cost of workers' compensation made it more expensive for employers to prevent injuries in advance than to pay when they occurred. "Therefore," he concluded, "unless and until the basic economics of these disasters are changed, nothing in the working place may change" (*Legislative History of the Occupational Safety and Health Act of 1970*, p. 891).

Congress brushed aside both arguments, whose complexities clouded the chance for decisive action. Instead, it seized on the same kind of intervention it had been using since the creation of the Interstate Commerce Commission in 1887. It never looked at the causes of workplace injuries or asked whether direct regulation was likely to work. Nor did it consider compliance costs, assuming that these could easily be paid by business or passed to consumers. Debate

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centered on a symbolic issue: whether rulemaking and adjudication powers should be separated from a Labor Department that was also charged with enforcement. This issue, too, was resolved symbolically, with rulemaking and enforcement centralized but adjudication split off.

The statute that was enacted in 1970 relied on direct enforcement of detailed standards based on "the best available evidence." To offset the rulemaking delays inherent in this approach—and at the urging of business interest seeking greater "certainty"—the new agency was required swiftly to adopt several thousand existing safety guidelines developed by private groups. But this involved its own difficulties, for those guidelines had never been meant to be binding and carried their own burden of haphazard development, parochial interests, manufacturers' specifications, and outmoded public health rules.

Beyond this the statute was drastically underfunded for its mission of assuring "every working man . . . in the Nation safe and healthful working conditions." OSHA began with a first-year budget of under $35 million (and 400 inspectors) to cover nearly 5 million worksites —numbers ensuring that many sites would not see an inspector for decades. The statute authorized low penalties—no more than $1,000 for a violation likely to cause death or serious harm—made even lower by discounts for employer size, good faith, and past safety history. The standards would initially be enforced by Labor Department inspectors who had "policed" safety and health in comfortable obscurity under various procurement acts and were ill-prepared for judicial review or the tact needed where advance consent to inspection did not exist. Finally, the agency was allowed only four months to organize itself, to build a nationwide enforcement network, and to assemble a body of enforceable rules.

The results could have been predicted. OSHA adopted an avalanche of standards widely seen as incomprehensible and largely irrelevant. The new inspectors met instant hostility from businessmen whose chief contact with the federal government up until then had been filing tax forms. That hostility was compounded by the tendency of many inspectors to disregard variations between businesses, to cite each defect regardless of the employer's safety record, and to enforce rules with great rigidity. With no agreement on which standards violations required immediate attention, there was little incentive for employers to comply before an inspector's arrival. For most worksites, the chances of being inspected and the present value of future penalties were too small to compel safety investment in advance. There was no assurance that such investment would defer inspection or avert citations when the inspector did arrive. And as Congressman Burton had predicted, the most identifiable bookkeeping cost of workplace injuries—workers' compensation premiums—was too low (under 2 percent of 1977 payrolls on average) to spur corrective action.

To the extent that incentives for voluntary compliance existed, OSHA could not capitalize on them. Because the agency lacked technical depth, it was unwilling to give binding advice on the existence of violations and on acceptable remedies. Because it took literally its charge to protect *all* workers, it tried to cover every class of industry and worksite, protecting few workers well. Without a comprehensive philosophy it was enveloped in cross fires between competing priorities and interest groups. By prodigious effort it swiftly responded to news that vinyl chloride caused liver cancer in plastics workers. But it got snarled in a string of bitter, counterproductive controversies involving pesticides, kepone, noise exposure, farm coverage, and various enforcement practices. Its dominant mode became reaction rather than action. It grew dependent on a narrowing constituency, since the unions were the only ones prepared to defend it, no matter what.

. . . OSHA developed a carapace—a hardened set of perspectives, processes, and constituent relations—that would put most middle-aged agencies to shame.

In the short space of seven years, OSHA developed a carapace—a hardened set of perspectives, processes, and constituent relations—that would put most middle-aged agencies to shame. Many Carter administration acts can be seen as attempts to puncture this carapace, or at least soften it. But these efforts have been impeded by the organized labor's reaction to its recent

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defeats on common-situs picketing and labor law reform, while the current battles over the Davis-Bacon Act continue to fuel union convictions that each barricade must be manned lest forty years' gains be swept away. As one senatorial expert has remarked off-the-record, "For the unions OSHA is a religion. There is no middle ground."

Pitfalls and Compass Points: A Future Map

Given this polarization, is there any hope for real OSHA reform? The answer is a qualified "yes," turning on whether a middle ground can be forged and on the type of reform being considered.

The market failures often cited to support the creation of OSHA—lack of information, unequal bargaining power, externalities (in which the costs or benefits of one party's action are borne or enjoyed by others)—are real, and still justify intervention. The agency's shift in emphasis from safety to health—where externalities run rampant, invisible hazards limit self-help, and standards lend themselves to the flexible performance requirements of exposure levels—is also justified. Galling as its paternalism may be to some, OSHA seems to have correctly concluded that "informed" worker choices often contravene the general good, since health probabilities are not real to people. And the agency's distrust of unrestrained corporate action has also been confirmed. The power company's post-incident actions at Three Mile Island—like recent revelations of cover-ups by asbestos firms—scarcely warrant a benign faith in free markets here.

But all this does not justify the kinds of standards or enforcement tactics OSHA has adopted. Nor does it justify treating all employers like criminals—an unwarranted approach that is certain to distort policy. Indeed, if it were true that without direct inspection most employers would evade reasonable safety obligations, there would be little point in having OSHA. For as Senator Peter Dominick (Republican, Colorado) noted,

> We could not possibly find enough inspectors to impose upon this vast area . . . a bill which people will not voluntarily comply with in a great majority of the cases. And if the American public . . . feels that the bill . . . is going to inject [an arbitrary] Federal agency into their business . . . we are really going to have bad problems with it (*Legislative History*, pp. 471-472).

Thus, though complete deregulation does not seem desirable, there is much room for improvement in regulation. OSHA clearly needs to give employers greater certainty that good performance will be recognized by reduced intervention. It should provide detailed information on major hazards and acceptable controls—and stand behind its advice. It should accept the fact that broad-scale improvement requires government, business, and workers to share responsibility, since no agency can do the job alone. And it should start measuring employers, as well as its own inspectors, by results rather than by compliance with mandatory procedures—admitting, in other words, that it is not omniscient and that there are many roads to the same end.

[OSHA] should start measuring employers . . . by results rather than by compliance with mandatory procedures—admitting, in other words, that it is not omniscient and that there are many roads to the same end.

Specifically, OSHA should:

- *Maximize inspection returns* by revising its enforcement priorities and by going where the injuries are. One way to do that is to conduct more accident investigations and focus inspections on individual establishments having high rates of serious injuries—an approach that would create strong incentives for employers to control conditions that cause injuries, even when those conditions do not violate standards. Another is to limit inspections to the ten or fifteen principal hazards in the inspected firm's industry. Another might be to make each inspector permanently responsible for 100 establishments having high rates of serious injuries and to hinge his or her advancement on getting those rates down.
- *Reduce the adversarial nature of standard-setting and enforcement* through greater reliance on cooperative structures and more realistic expectations. Plant or industry-wide worker-management safety committees could

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be used to rank hazards by degree of danger, to point OSHA toward regulatory opportunities, to promote cooperative problem solving, and to help make inspections a last resort rather than first-instance reflex. Standards should be focused on core hazards, the unquestionable dangers, where popular perceptions would work for rather than against the agency, with the debatable periphery left alone until a consensus for expanding the rule is formed. OSHA has taken this tack on an ad hoc basis—most recently in deciding to exempt retail gasoline stations from its benzene standard. It should do so across the board, and stop trying to write or enforce "perfect" rules designed to remove every trace of each hazard at a stroke.

- *Create incentives for change.* Firms with exemplary safety records have management tools for attaining those results, and 90 percent of work injuries involve behavioral or supervisory factors which are difficult to affect by direct regulation. Broad improvement may thus require incentives for top management to tackle these problems through organizational change. Two powerful incentives might be mandatory disclosure to shareholders of injury rates above industry norms and extension of the investment tax credit to training and other non-capital safety expenditures. Also, companies might be permitted to deduct as a business expense only the *average* workers' compensation premium for their industry and size class, a rule that would reward firms with low rates of serious injuries and differentially tax those with high rates.

- *Build a broader constituency* by articulating its own view of the public interest and setting concrete goals for which the agency would be accountable. While recent polls show the public continues to favor government regulation of job safety by a majority of 52 percent to 12 percent, they also show that only 35 percent of workers think such regulation important *to them.* For environmental protection the figures are 70 percent and 70 percent. Other polls show citizens willing to spend over $100 more per capita for air and water cleanups, but less than $10 more for job safety and health. These figures imply that commitment to job safety and health does not run deep or wide enough to make the subject a top national priority. They mean OSHA must do a better job of establishing its credibility and the credibility of its mandate with the general populace—by stressing, for example, the benefits of its actions for families and communities as well as for workers themselves.

Such reforms seem necessary if OSHA is to defuse apparently perpetual controversies and protect workers better than it has. But to the extent reform is initiated by those seen as OSHA's opponents, it will fail. Those seeking change must admit that standards and inspections are needed to inform workers and keep employers honest. They must agree that increased flexibility for business means stronger sanctions when flexibility is abused. They must build from within, not try to wipe the slate clean. And they must be supporters of OSHA—friends urging constructive change in order to forestall something worse.

This is a tall order. It will be made taller by the fact that many companies and unions prefer confrontation to accommodation—that having learned to use the present system, they will stick with the devil they know. And it is not likely to be lowered by procedural steps like sunset laws or requirements for regulatory analyses. Analyses may delay, but are unlikely to alter, the course of an agency that responds far more to constituent pressures than to analytical determinations. And despite their political weakness, the two agencies that have so far experienced sunset review under enabling statutes—the Consumer Product Safety Commission and the Commodity Futures Trading Commission—emerged with larger budgets and stronger relationships with their respective constituents and congressional committees. The fact is that constituents have powerful stakes in existing systems, however imperfect, while authorizing committees feel their past performance is on the line. That, after all, is the definition of a system: a world that has reached equilibrium and resists any impetus for change.

SERIOUS REFORM of OSHA will come only through the convergent desires of the agency, a significant part of its constituency, and members of Congress who see more political gain in forcing change than in avoiding the issue. That will require time, hard work, and a perception that the current structure is in mortal danger. The most likely prospect is more of what we have—or a gutting amendment whose effects even its sponsors cannot foresee. ■

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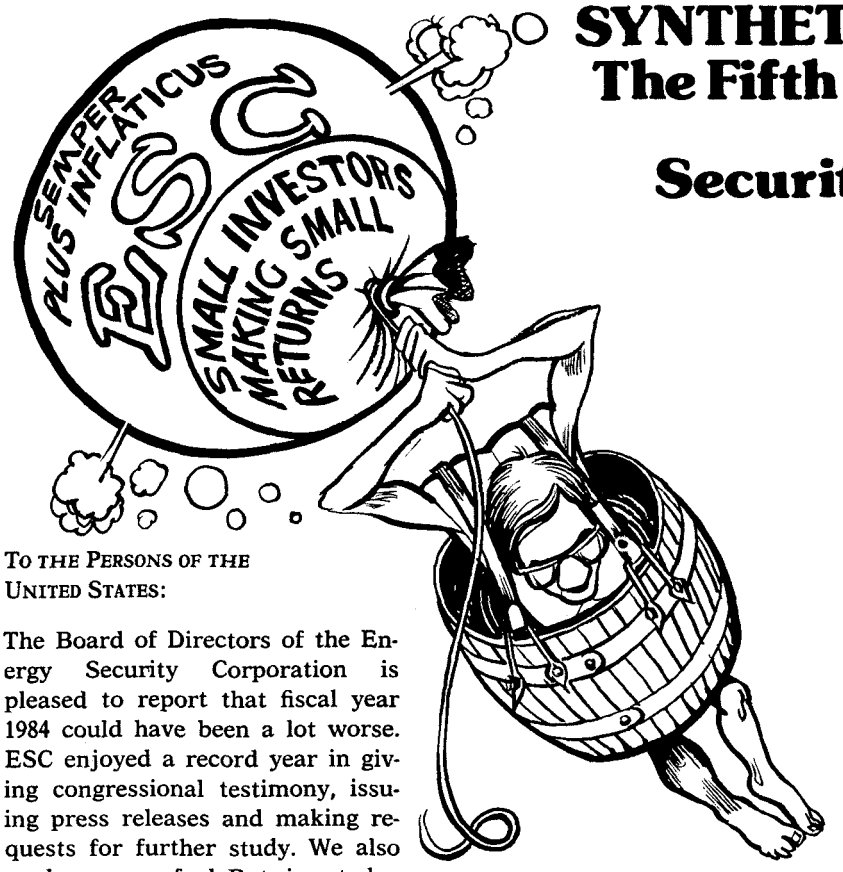
SYNTHETIC PROGRESS
The Fifth Annual Report of the Energy Security Corporation, July 15, 1984

Gregg Easterbrook



TO THE PERSONS OF THE UNITED STATES:

The Board of Directors of the Energy Security Corporation is pleased to report that fiscal year 1984 could have been a lot worse. ESC enjoyed a record year in giving congressional testimony, issuing press releases and making requests for further study. We also made some synfuel. But since today is your company's fifth anniversary, it seems appropriate to reflect on the hurdles we have surmounted. This will remind us how the philosophy of a common people's oil company—small investors making small returns—came to be.

ESC was conceived five years ago by President Carter. On that day, he declared it intolerable to pay $20 a barrel for oil. Then, unable to find oil for less, he boldly opted for second best. Synfuel could be made for $40 a barrel, which is different from $20. "If we can't pay less," said Carter, "we'll have to pay more." Thus was coined your company's motto, *Semper Plus Inflaticus.*

As you remember, most ESC capital was to have come from taxes on the profits that oil companies made by selling "old" oil as "new" oil—erroneously called a "windfall" tax. But ESC soon came to grips with a heady threat—"old" oil would someday be used up, and thus would end your company's liquidity. So in 1981, laws were passed to impose a true "windfall" tax directly on the oil companies' profits.

Complications, professors of economics were pleased to discover, were unavoidable. ESC quickly realized that funding could be guaranteed—and precious synfuel made—only if oil companies made baronial profits. Otherwise, there would be nothing to tax. The way to ensure this was, of course, to force oil companies to raise their prices.

You may recall that some controversy surrounded passage of the ESC-sponsored Energy Blackmail Act of 1982. Initially consumers were upset when ESC Price Police arrived at gas stations in their baking-soda-powered squad cars, busting discounters and posting weekly price increases as required by the act. They were further dismayed as mass transit subsidies were ended and assembly lines for fuel-efficient cars were closed down. (This fine-tuning of regulatory policy was necessary to keep gas demand high.) But, in time, the public understood that—since windfall profits financed ESC—common people had a vested interest in high prices. "Gas price extortion is good for everybody!" became one of the nice things you could say about America. The great economic experiment continued.

As you, the people, are well aware, ESC also raises capital by selling bonds in the small denominations that interest small investors. Common people drawn into energy investments for the first time were surprised to discover that pieces of other firms were available in small denominations as well. Gulf Oil's common stock was selling at $32, for instance, and Texaco's at $29. Management confesses that, at first, this revelation gave us pause. But transactions in the stock of oil companies proved hopelessly confusing to small investors. They might buy a share at $29 and soon discover it had gone up to $60—no longer the desired small denomination! Investing in ESC poses no such problem.

Small denomination bonds have proved vital to your company because, we soon found out, no one

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was interested in large paper. After extensive polling, ESC market analysts discovered that poor people fail to buy $1,000 bonds, not because the denomination is inconvenient, but because they lack money. Wealthy people, on the other hand, were found to have the money. They, however, believe that better rates than the ESC bonds' taxable 5 percent (so successful with U.S. savings bonds) are available. ESC assures you that, if all corporations were run by the government, this inequity would quickly be corrected.

With this background in mind, management is pleased to transmit a summary of operating results for fiscal year 1984. ESC had revenues of $16.1 billion. Of this, $7.3 billion came from the sale of 500,000 barrels of synfuel and $8.8 billion from windfall profits taxes. Revenues were a hefty 83 percent higher than 1983 revenues of $8.8 billion. The reason is that, for the first time, ESC actually sold some synfuel.

Expenses were $16.1 billion. The chief outlay was $7.3 billion for the purchase of synfuel. Another $7 billion was invested in new projects, while $1.8 billion went to administration, press releases, and fighting lawsuits against other government agencies.

This left net income of zilch. Under some accounting schemes, not all of the $7 billion invested would have been considered expense. Instead, an amount to be "depreciated" each year would have been arrived at by dividing the total by some number of years—say, twenty. ESC would then have shown a "paper"—or windfall—profit. But the Internal Revenue Service advised us that all synfuel investments must be depreciated through the little-used "straight down" method. Since IRS considers the return potential of synfuel to be zero, each dollar is fully depreciated the instant it is committed.

Careful students of economics may note that figures for synfuel sales and purchases were, in a manner of speaking, identical. This is because ESC itself bought all the fuel it produced in 1984. Management admits this to be a setback. Built into the country's energy-wasteful system are insidious prejudices against the sale of a $40 substitute for a $20 commodity. This anomaly should soon correct itself. Perhaps we will be favored by some positive turn of events, like another oil embargo or a series of supertanker disasters. Until then, ESC is confident that it, itself, represents an unlimited market for its own product.

Many synfuel projects, like coal gasification or alcohol distillation, actually consume more energy than they produce. It can plainly be seen that the more synfuel ESC makes, the more it must buy: it will never be possible for ESC to keep pace with its own demands. Truly, no company restrained by conventional economics could offer its investors such a secure market.

In the event, however, that surplus synfuel should become available, ESC has important plans. As announced last month, it has made a tender offer to acquire the Strategic Petroleum Reserve, the government program to store oil in salt domes against the prospect of shortages. Merger with SPR would be a somewhat complicated transaction involving treasury notes, bonds, stocks, and indebentured servants; ESC has retained the entire faculty of the Wharton School of Business as placement counsel in this affair. If the deal goes through, it would achieve for your company the ideal vertical integration—taking fuel out of the ground and immediately putting it back in.

In other matters, ESC is pleased to announce a technological breakthrough. A drawback to making synfuel from coal or oil shale is that the process requires oceans of water. Yet shale reserves are located in arid states where water is already scarce. Thus scientists were delighted to discover that the atmospheric "greenhouse effect," caused by burning coal, is melting the polar ice caps. Management need not detail the beneficial effects this will have on fresh water supplies. And this abundant new water source will be enjoyed in coastal towns the world over.

Far from being discouraged by near-term realism, ESC has set ambitious goals for 1985. We will invest $10 billion in new synfuel projects. Left to its own devices, this money would be lost in a dizzying series of "multiplications." Half would go to buy oil at $20, enter OPEC pockets, then come back to the United States as investments in shoe factories or other goods. Soon it would be reinvested in something else; and on and on, with bewildering ramifications. The other half—money unspent if $20 oil were bought instead of $40 synfuel—*would never be used for energy purchases at all.* Consumers might spend it on outdoor carpeting, stereo headphones, or even food.

One can easily see how this aimless scattering of funds throughout society does little to create a sense of energy crisis. Quite otherwise with ESC projects, however. They send jobs and factories—real resources—deep into the desert where they can be watched. And from where they are unlikely to escape.

In sum, 1984 has been a year for your company. But ESC's true contributions lie beyond its synthetic progress. By selling 5 percent bonds to average Americans once content to enjoy their hard-earned money, we have taught them a valuable lesson. More important still, we have jacked up gas prices to create windfall profits; which finance ESC; which pays the bond interest for the little people who pay the high prices. This proves that social progress and profiteering *can* go hand-in-hand.

But most important of all, this arrangement—by seeing to it that every American, rich or poor, is ripping off every other American—has restored confidence in our system. That would have made President Carter proud.

Alfredo D. Darke,
Chairman of the Board

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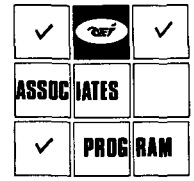

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REGULATION, LOGIC, AND IDEOLOGY

Jerry L. Mashaw

THIS ESSAY is not another call for deregulation or another defense of some institutional device for reforming the regulatory process. Instead, I want to speculate about the political and legal dynamics of regulation, and to isolate some of the reasons regulatory programs develop as they do. I am not here concerned with stories of regulatory failure brought about by client capture, or with murky conceptions of the public interest, or with undefinable regulatory outputs, or with bureaucratic bungling. Instead, I hope to describe attributes of the post–New Deal perception of social and economic problems that combine with the modes of operation of legal institutions — legislatures, administrative bureaus, and courts—to produce a kind of "progressive logic of regulation."

In my view, the internal problem-response dynamic of the political-administrative-regulatory system tends *of itself* to produce increasingly stringent and pervasive regulation. But, this progressive logic is not inexorable. Indeed, as we shall see, the logic has been supported by a political ideology—what I call here the ideology of governmental efficacy. But that gets ahead of our story.

The Progressive Logic of Regulation

Step One: The Legislature Defines the Problem. One is often struck by the discontinuity between the evidence of social and economic malaise upon which legislatures operate and the way the legislatures define the problems they address. The evidence is usually specific, limited, even anecdotal, but the problem as defined is general. If a toxic fog appears in Pennsylvania, the problem, as defined, is somehow not that a toxic fog appeared in Pennsylvania, but air pollution control. If Corvairs are unsafe, the problem is motor vehicle safety. If a drug manufacturer in North Carolina markets an otherwise safe compound in a toxic solvent, the problem is pharmaceutical safety.

This kind of discontinuity is not the result of simple stupidity or cussedness on the part of legislators, but reflects the common, "there oughta be a law" reaction of the general population. That reaction has embedded in it the notion that "things like that" (whatever the disaster or crisis of the moment may be) should not, *in general,* be allowed to happen. The law that "oughta be" is one that would prevent all such mishaps.

It may also be the case that this generality is required by the limits on legislative competence. There are, after all, constitutional prohibitions against specific or retroactive laws (bills of attainder, ex post facto laws); and the awarding of compensation on general common law principles is the function of courts—not of legislatures. If a legislature is to respond to political demand, it is virtually constrained to do so in general ways.

Step Two: The Legislature Formulates a Solution. Legislatures generally appreciate the lack of fit between the events that have occurred and the policy problem as defined. They indeed seem acutely aware that the facts that give

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rise to a sense of alarm do not provide an adequate basis for a general solution. The legislative problem, then, is how to act quickly, while avoiding massive legislative error through hasty generalization (or perhaps, merely while avoiding difficult choices). The answer quite often is to move to a higher level of generality—to address the issue not even in general policy terms, but as a problem of institutional design. The need for a policy is redefined as a need for an institution that can focus on the policy question over time and can devise solutions in the light of this experience. The regulatory agency is, of course, such an institution.

The need for a policy is redefined as a need for an institution that can focus on the policy question over time and can devise solutions in the light of this experience.

I do not mean to suggest that legislatures move in one giant step from a specific problem to an all-powerful regulatory agency. Indeed, regulatory legislation is almost always a compromise between pro- and anti-regulation forces which results in limited agency jurisdiction and, particularly, limited agency legal powers and physical resources. But, as we shall see, regulatory systems tend, through a kind of innate logic, to surmount early compromises and to move toward more complete regulatory control.

Step Three: The Agency Selects Its Approaches. Once established, the regulatory agency faces the task of implementing the legislative intent. Usually that intent is somewhat problematic—regulatory legislation abounds in "public interest" standards and laundry lists of contradictory goals. But core areas are not usually in doubt: the agency is to do something about the general classes of problems that caused the legislature to act in the first place. (Hence, perhaps, the satirical but not implausible agency rule of statutory interpretation: if the legislative history is in doubt, it is permissible to consult the statute itself.) And should there still be grounds for arguing about the boundaries of those problems, a generous definition of what they are ensures that the agency is not charged with failing to implement the legislature's mandate.

The basic challenge for the regulatory agency is to prevent the occurrences that led to its creation, while staying within the constraints on its fiscal resources and legal techniques. The regulators respond to this challenge at each of the three stages of administrative implementation: (1) data collection, (2) policy formulation, and (3) enforcement.

- *Data collection.* Obviously the cheapest way for regulators to obtain information about the part of the world potentially subject to their jurisdiction is to require that someone else supply the information, at that someone else's expense. In fact, one finds a substantial number of data collection and reporting requirements in agency regulations. Sometimes these requirements are directly authorized by statute; other times, though not authorized, they are imposed by the agency's threat to use powers that *are* authorized—and can be exercised or not depending on the cooperativeness of the regulated parties. In addition, regulators can obtain information simply by proposing to adopt certain policies and then waiting for those who favor or oppose the policies to supply the facts and arguments supporting their positions. This private production of public information costs the agency—and the legislature—nothing. And, given the usual demand for a commodity at zero price, it is not surprising to find that recordkeeping and reporting demands are high on the list of complaints by those who claim that regulators overregulate.

- *Policy formulation.* Here too, one should expect agencies to prefer procedures that are least costly to them. The least-cost method is perhaps a single secret meeting, while the highest cost is the evolution of precedent in a series of decisions after trial-type proceedings. Between these extremes lie any number of variations, including the standard method set forth in the Administrative Procedure Act—notice in the *Federal Register*, opportunity for written comment, and publication of a final rule. What is to be noted is that the methods least costly to the agency are also those most likely to produce general policy rather than limited decisions. The use of general rules both economizes on the resources an agency need commit to

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policy development (thus permitting more regulatory activity of other kinds) and maximizes the reach of any particular policy. It is not surprising to find that regulators often gravitate toward rulemaking as their dominant regulatory technique and that the regulated complain loudly of overly generalized—and thus to some degree unnecessary—regulations.

Of course, it also costs the agency something to make wrong decisions—that is, to choose wrong policies. And agencies can hardly expect to be right every time. Regulators, therefore, need guidelines for making decisions in the face of uncertainties concerning both the incidence and seriousness of problems on which they have incomplete information and concerning the costs and benefits of deciding now as against waiting for better information. A decision rule that resolves doubts in favor of regulating now, as if the problem were serious and pervasive, has obvious attraction. At the least it tends to ensure that the administrator is not embarrassed by recurrences of the difficulties that led to the legislative scheme in the first place.

A when-in-doubt-regulate rule will obviously entail some costs of overregulation (demands for useless information, unnecessary delays in producing needed goods and services, and so on), but those costs are often difficult to document and complaints about them can be put down to the usual carping of regulated groups. Failure to regulate, on the other hand, smacks of "irresponsibility," perhaps of "corruption." Overregulation does, of course, have political costs of the sort that are important to the agency in its relationships with the legislature—particularly relationships with individual legislators. Yet, the general impression of legislative oversight that one gleans from hearings or from General Accounting Office reports is of agencies subjected to continuous criticism for failure to regulate, not for regulation.

- *Enforcement.* The regulatory approach here mirrors the general approach to data collection and policy formation. In the best of all possible worlds for administrators—licensing—no potentially detrimental action can be taken without the agency's prior approval. The regulated party must come to the agency, supply all the data the agency deems relevant to decision making, and frequently accede to conditions on its future behavior (reports, inspections, audits) that will make the agency's continuous monitoring and enforcement job easier. Nor is it necessary to have statutory authority for a licensing scheme in order to create one. If the risks associated with other forms of agency enforcement (lawsuits, cease-and-desist orders) are great enough, a "voluntary" licensing system can be created.

Enforcement systems that rely on administrative adjudication of violations are less effective than licensing. But if such systems can be combined with regulatory rules that make proof of a violation relatively straightforward, then regulatory enforcement power remains substantial. If the Federal Trade Commission (FTC), for example, must prove in a protracted adversary proceeding that an oil company's failure to post octane ratings on its pumps is an "unfair or deceptive act or practice," it can undertake few such proceedings and "voluntary" compliance is likely to be low. If, on the other hand, the FTC can adopt a rule that all companies must post octane ratings, then any enforcement action would be limited to proof that the ratings were not posted. Few companies would want to litigate that question, and voluntary compliance should be forthcoming from most or all. In short, regulators who desire to establish an effective enforcement process want to move as far away from judicial and administrative trials, and as near to pervasive licensing requirements, as possible. The movement is, of course, from less regulation to more.

The example of octane posting suggests a particular regulatory move that reduces enforcement problems—that is, the move from general performance criteria to specific directions that can be more easily monitored or enforced. In pollution control, for example, the move has been from ambient water and air quality standards to effluent limitations and finally to equipment specification. Motor vehicle safety regulations, notwithstanding statutory language to the contrary, have moved inexorably from performance toward design criteria. Occupational safety and health regulations reveal a similar pattern. But the move is not without costs. This tendency to trade the compliance efficiencies that might emerge from diverse approaches for the enforcement efficiencies of objective, performance proxies, or

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design requirements is often criticized as a form of overregulation.

Step Four: The Judiciary Upholds the Agency. The progression we have been describing, from limited problems to pervasive schemes, has not taken account of the fact that judicial review may limit both legislative and administrative policy making. But the record of judicial review of regulatory activity suggests that we need not make much of this—for it is in many ways the record of failed attempts to interdict the progressive logic of regulation. The twin stories of judicial attempts (1) to prevent legislatures from making general regulations to deal with individualized (or arguably nonexistent) problems and (2) to inhibit the adoption of institutional solutions to policy problems are well known. They are the stories of substantive due process and the nondelegation doctrine.

General judicial approval of agency attempts to render regulation more effective, through resourceful use of licensing and rulemaking techniques, is of more recent vintage and not yet complete. Courts do not approve all agency exercises of power. Yet the tendency to approve administrative techniques for increasing regulatory power is marked. In case of doubt the operational rule of statutory construction for reviewing courts is to support agency action. The logic of doing so is impeccable. The role of the reviewing courts is to see that the congressional will is done. The agency justifies its actions as ensuring more effective implementation of that will. Q.E.D.

Step Five: Regulation Begets Regulation. Not only is there a progressive logic within regulatory programs, but regulatory activity also helps to identify yet more problems needing regulatory attention. As the United States moves into the regulation of water quality and air quality, we begin to see more and more how these aspects of environmental quality are involved with solid waste disposal and land use planning generally—and we seek to regulate the latter also. As we encounter and regulate toxicity in foods, drugs, and workplaces, we perceive residual categories of danger that can be approached only by regulating toxic substances as a whole. The opportunities for generalizing regulation abound. And the combination of evasive action by regulatees and the desire to motivate staff provide additional reasons for taking new regulatory initiatives. Indeed, given a relatively well-developed administrative state, the primary impetus for new regulatory legislation may come from the results of old programs and the initiatives of old agencies. In the United States today, step five in our process may be—I think it is—more common than step one.

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It is true that the progressive logic of regulatory expansion need not always lead us astray. If what we have been saying is correct, regulation does have a capacity to generate new data that not only identifies new problems, but also might make our subsequent efforts better informed. The bureaucratization of the Congress may have similar effects. But I am not wholly convinced. Trucks were regulated because railroads were, and when airplanes came along, regulating them seemed the natural course. And I find preposterous the extension of the Federal Communication Commission's jurisdiction to cable television. Cable, after all, solves for many television markets the technological problem that motivated the regulation of access to broadcast frequencies in the first place.

The Logic in Action

The story I have told thus far is obviously oversimplified. There are, after all, other stories of hesitant legislatures, timid administrators, agencies that produce their own information, and obstructionist courts. Yet our experience lends support to the simplified outline I have given here. Let me fill in that outline with an example: the federal regulation of pharmaceuticals.

Pure Foods and Drug Act of 1906. Significantly, the "harmful event" that gave rise to the direct

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predecessor of the current Food, Drug, and Cosmetic Act was contrived by an already existing agency. (I am not sure how far back we have to go to find a step one uncomplicated by elements of step five.) In the early years of this century, Dr. Harvey Wiley, chief of the Division of Chemistry of the U.S. Department of Agriculture was determined to have Congress deal with the problem of toxic food preservatives. After failing several times to stimulate legislative action, he concocted the idea of forming what he called his "poison squad"—a group of twelve who volunteered to eat meals laced with the common preservatives of the day: borax, boric acid, formaldehyde, sulfurous acids, copper sulfate, salicylic acid, benzoic acid, and benzoates. Analysis of the effects of these chemicals on the "digestion and health" of the volunteers convinced the Congress. It banned interstate shipments of "contaminated" foodstuffs and, somewhat strangely given Wiley's interests, of "misbranded" drug preparations.

The Food, Drug, and Cosmetics Act of 1938. The so-called Wiley Act of 1906 served as the basic statute governing federal drug regulation for thirty-two years—even though the Bureau of Foods and Drugs had thought it inadequate for some time. The bureau could proceed in court against foods that were adulterated (made dangerous by some constituent) and drugs that were misbranded (fraudulently labeled). But proving to the satisfaction of a court that some long-used food preparation was dangerous or some drug fraudulently labeled was a difficult business. Given its resources, the bureau could not make much headway against the ingenuity of entrepreneurs who were busily concocting thousands of new preparations each year and who needed only to be circumspect in the *labeling* of their products to avoid censure. Under the 1906 act the bureau could not require disclosures on the labels, nor could it regulate advertising claims made elsewhere than on the label. Also, it had no way to prevent the marketing of new drugs; it could act only after the damage was done.

As early as 1933, bureau chief Walter Campbell convinced Assistant Secretary of Agriculture Rexford Tugwell that new legislation was needed. But Tugwell could not convince President Roosevelt. Then, in late 1937 came a fortuitous disaster. A drug manufacturer seeking to broaden its participation in the new and growing sulfa drug market developed the first liquid sulfanilamide preparation, using diethylene glycol as the solvent. No tests for toxicity were run before marketing. As events demonstrated, diethylene glycol induced kidney failure. Over 100 persons died before the Bureau of Food and Drugs could track down and seize all of the first forty-gallon batch of "Elixir Sulfanilamide—Massengill." Indeed, it was able to proceed at all only on the theory that "elixir" fraudulently suggested the presence of alcohol in the compound.

Within months of the tragedy, Congress adopted a comprehensive new law covering foods, drugs, and cosmetics. Under the 1938 act drugs were required to be safe, and the newly established Food and Drug Administration (FDA) was given licensing authority over all "new drugs"—that is, drugs not "generally recognized as safe by recognized experts." Such authority obviously could be used—was intended to be used—to require the testing of new drugs for safety before they were marketed.

We might note, of course, that the legislative response somewhat overgeneralized the problem. Not only did the new statute cover foods and cosmetics (where there was, to be sure, plenty of evidence of toxicity problems, although none so dramatic as in the Elixir Massengill case), but it was considerably broader than the facts might have warranted. The failure of a company to test a new product for toxicity was made the occasion, not for a requirement that companies test their products, but for a requirement that they obtain licenses from the FDA approving the safety of their preparations. Rather than specifying the testing that was to be done and sanctioning the failure to test with the traditional judicial remedies of seizure, injunction, or criminal prosecution, Congress gave the FDA the power to develop drug-testing policy through the exercise of its power to withhold licensing approval. Responding both to external events and to the internal logic whereby regulation begets regulation, Congress expanded the agency's power.

The 1962 Amendments. For nearly a quarter of a century thereafter, no major changes were made in the 1938 act. Then amendments passed

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in 1962 enormously increased the FDA's impact by requiring not only drug safety but drug efficacy—*both* to be demonstrated by "substantial evidence" (including "adequate and well-controlled clinical studies").

Curiously, the principal force behind the amendments, Senator Estes Kefauver (Democrat, Tennessee), was primarily concerned with the *price* of pharmaceuticals. In a series of investigative hearings he came up with evidence showing considerable similarity in pricing on the part of drug firms and what appeared to him to be an astronomical industry-wide profit margin on many drug preparations. Following the hearings, Kefauver introduced a bill (1) to restrict patents on pharmaceuticals and require their compulsory licensing after three years, (2) to limit the profits on brand-name drugs by requiring that the generic name of the drug be disclosed in labeling and advertising, and (3) to reassure the medical profession about the quality of the far cheaper generic drugs by providing for industry-wide inspection. As a further protection against false claims, the bill also provided that new drugs be licensed only if "effective" as well as safe.

The 1962 amendments as passed embodied a twofold irony: they had little to do with what concerned either Kefauver or the public. First, Congress rejected virtually all of Kefauver's price-reducing proposals; and while it accepted the generic name and effectiveness provisions, the senator set no great store on the latter as consumer protection measures. Second, what concerned the public was safety, not efficacy. The Kefauver bill was going nowhere until the thalidomide tragedy generated interest in drug regulation. But neither the generic name provision nor the effectiveness provision would have made any difference in the thalidomide case. Thalidomide, which was an effective but unsafe generic drug, had not been approved for marketing in the United States under the 1938 act.

To be sure, the demand in the 1962 amendments for "well-controlled clinical studies" was germane to the safety issue. But that provision was (and herein lies a third irony) part of a deal with the pharmaceutical industry that was thought, at the time, to *reduce* the amount of proof needed for FDA approval of a new drug application from a "preponderance" of the evidence to "substantial" evidence.

The FDA's Problem. As of 1962, then, the FDA was administering a comprehensive licensing scheme under which drugs had to be tested clinically for safety and efficacy if they were to be admitted to or remain on the market. But to say this seriously overstates the FDA's effective control. More drugs were on the market than anyone realized, with estimates ranging from 100,000 to 250,000. Very few of these had been submitted for safety review under the 1938 act, and manufacturers would be slow to change their practices in this regard. Moreover, the 1962 amendments applied only to "new drugs"—defined in the statute as drugs "not generally recognized as safe and effective." Few manufacturers were willing to concede that their existing drugs were not so recognized and, indeed, some took the position that certain drugs marketed for the first time after 1962 were not new because they were sufficiently similar to pre-1962 drugs. (The peculiar meaning given to "newness" in the statute—one permitting a drug that has been marketed for years to be classified as new—produced understandable confusion on the reach of the 1962 amendments.)

In short, drug firms did not suddenly perceive themselves to be part of a pervasively regulated industry, and did not willy-nilly apply for FDA permission to put or retain all their preparations on the market. Moreover, the FDA's enforcement powers were unchanged. If it thought a new drug was being marketed without an approved new drug application (NDA), it had to pursue the drug or its manufacturers in court. There it would have the burden of proving that the drug was not generally recognized as safe and effective. For all the hundreds of thousands of drugs on the market, this was hardly feasible. Besides, even if the manufacturer submitted to the FDA's jurisdiction, the statute required that the agency give the manufacturer a formal hearing before denying clearance—an important requirement since the agency had, in 1962, only two hearing examiners (one of whom had been tied up for nearly ten years in a formal proceeding on the definition of peanut butter).

In a nutshell, at one and the same time the agency was empowered and rendered impotent by its legislative mandate. It had a mammoth regulatory task, but only time-consuming means of enforcement. In its case the licensing

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technique, which in general gives administrators considerable leverage, seemed to confer no appreciable power. The definition of "new drugs" (those not generally recognized as safe and effective) permitted the potential licensees to confer the license on themselves, or at least to believe that they already held one.

Really, the FDA had two problems: (1) convincing manufacturers to submit post-1962 drugs, and pre-1962 drugs never previously submitted, for approval and (2) developing an expeditious procedure for revoking pre-1962 safety approvals for drugs that were not generally recognized as effective. The first problem could be solved only in the courts and then only if the agency could make wholly unrewarding any litigation concerning "newness" (does the drug have current "recognition"?) or "grandfathering" (was the drug generally recognized as safe and effective prior to the 1962 act?). Several courts did award the FDA summary judgment against drugs on the strength of a simple affidavit that no medical literature had been found reporting the results of clinical trials concerning them. But most preparations did not fall into this category.

The problem of revoking pre-1962 approvals posed similar difficulties. The FDA contracted with the National Academy of Sciences–National Research Council for a review of the effectiveness of all its previously approved drugs, based on the existing literature. But when the agency proposed, following NAS-NRC recommendations, to withdraw a prior approval, manufacturers uniformly demanded trial-type administrative hearings—hardly less burdensome than court trials. Indeed in one sense, the administrative hearings were more burdensome: the FDA had to supply the hearing officers.

The FDA's Solution. After false starts and some confusion, the agency devised a solution to its legal problems. The solution involved three somewhat problematic assertions:

- First, that the agency had the power to define by regulation the attributes of "substantial evidence"—including the attributes of an "adequate and well-controlled clinical study"—*and* to treat as not generally recognized as effective any drug that had not been proved effective by such a study. With this power claimed, the FDA proceeded to define "substantial evidence" to include only evidence of the highest scientific caliber—basically a double-blind clinical study in which neither patients nor doctors know who is receiving the tested drug. And it claimed that "general recognition" and "substantial evidence" were the same question (thereby rendering wholly irrelevant the results of years of clinical use by thousands of physicians who were prepared to attest to a drug's efficacy).
- Second, that satisfaction of the substantial evidence standard was a question within the agency's primary jurisdiction—that is, "newness" not only need not but could not be litigated in court. This assertion of primary jurisdiction to make "newness" decisions was a sharp departure from prior practice.
- Third, that the FDA could refuse a request for a hearing and award itself summary judgment, withdrawing an NDA whenever the evidence submitted in favor of a drug did not measure up to the agency's substantial evidence definition. This summary judgment power seemed to read the hearing provision out of the statute. If the evidence were not substantial, then no hearing would be granted. If it were substantial, no hearing would be necessary, and the drug would simply be approved.

The validity of these claims was ultimately put to the Supreme Court in five companion cases, decided in 1973. The FDA's basic argument to the Court was that Congress had intended in 1962 to institute effective, pre-clearance regulation of drugs. The agency could not, it argued, carry out that legislative mandate except with the powers asserted. Indeed, the agency went further to suggest that any diminution of the powers asserted would undermine not only what the agency had done, but also its future plans. Those plans included standardizing the composition and labeling claims of the tens of thousands of over-the-counter drugs by issuing general regulations that would exempt from NDA approval drugs that satisfied the composition and labeling instructions of the proposed OTC monographs.

The FDA prevailed on every issue. On each interpretive question there was some legislative history or some prior judicial decision concerning the inherent power of some other agency that supported the FDA's position. In cases of doubt—and all the FDA's assertions of power were in some ways doubtful—the propensity to

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interpret statutes in ways that would further the general regulatory purpose tipped the balance. Phrases like "only paralysis would result", "the overriding purpose of the 1962 Amendments", "the deluge of litigation that would follow", and "the regulatory scheme would be severely undermined" punctuate the Supreme Court's opinions.

The Ideology of Governmental Efficacy

I do not know whether this tendency to extend and generalize the regulatory posture of the FDA is proof that overregulation is abroad on the land. The question of how much regulation is enough is outrageously complicated. But it does seem clear that there are strong institutional biases—in legislatures, administrative agencies, and reviewing courts—toward resolving ambiguous questions of regulatory policy or regulatory power in favor of the exercise of governmental control. The Federal Trade Commission, the Federal Power Commission, and the Federal Communications Commission would provide a number of further examples —as indeed would the newer health and safety regulatory agencies (though the developments in the latter cases have not had nearly so long to work themselves out).

This progressivity of regulatory systems seems to be tied directly to the ideology of governmental efficacy—that is, the view that government is, and must be, an effective agent for getting things done. Only a legislature committed to that ideology need act to solve problems in the face of pervasive uncertainties about their dimensions and their remedies. Only administrators who view ineffectiveness as the cardinal bureaucratic sin need resolve jurisdictional doubts and surmount budgetary constraints by exploiting techniques for amplifying their power. Only courts that accept, at least implicitly, this dominant political ideology could resolve conflicts concerning private rights and governmental power by invoking the government's *need* for the power asserted.

It is from this perspective that we should view many contemporary proposals for regulatory reform. Legislative vetoes, sunset laws, regulatory budgets (budgets reflecting the costs of compliance), and regulatory impact statements are all devices for inhibiting the progressive logic of regulation. Each provides some new stopping point for evaluating policy or institutions, and some opportunity for analysis free from the inertial force of an ongoing regulatory system. But, from this perspective, one may doubt that these devices by themselves will have a substantial impact on the amount and kind of regulation. Without an ideological shift of some proportions they seem doomed to ineffectiveness.

Only courts that accept, at least implicitly, this dominant political ideology [of governmental efficacy] could resolve conflicts concerning private rights and governmental power by invoking the government's need for the power asserted.

Yet, it will be said, surely these proposals and their growing political acceptance suggest that such a shift is in fact taking place. Indeed, I would argue that like most other ideologies in American politics, governmental efficacy is recognizable as such only because we have begun to lose the faith. For years it masqueraded as a functional and pragmatic antidote to the "hidebound" ideology of free enterprise. Now, as we increasingly question the capacity of governmental institutions, the prior era's pragmatism is revealed as only another ideology.

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It is improbable, of course, that we will return to our once-upon-a-time free market ideology, just as it is improbable that we will pass through what President Carter terms our crisis of confidence to embrace once again the ideology of efficacy. We are probably headed somewhere else, toward some new ideology that will work itself out slowly and be fully recognizable only as it is passing away. As that process goes, so goes regulation. ■

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Readings
of particular interest

To Separate or Not to Separate

"The Decline of Separation of Functions in Regulatory Agencies" by William F. Pederson, Jr., in *Virginia Law Review,* vol. 64 (November 1978), pp. 991-1037.

The elimination of separation-of-functions requirements in nonaccusatory or policy-making proceedings of regulatory agencies "would be among the most significant advances in administrative procedure in the last thirty years," argues William Pederson of the Office of General Counsel, Environmental Protection Agency. Separation-of-functions requirements forbid agency employees who worked on the early stages of an issue from advising or consulting on the final decision. The policy-making or -applying function, Pederson argues, is what distinguishes agencies from courts, and the use of trial-like proceedings—in which separation of functions is applicable—is inappropriate.

Pederson points out that (1) distinguishing between accusatory and policy-oriented cases is not difficult, and thus imposing trial-like procedures on all agency decision making is not justified; (2) agencies should not be embarrassed about trying to implement legislative goals, and (3) procedural requirements that prevent agencies from dividing their labors rationally and efficiently can lower the quality of the final product.

Important changes have occurred since passage of the Administrative Procedures Act (1946), which required separation of functions in accusatory actions and created a special class of hearing officers. Hearings have become more like courtroom trials, and this formalization has "ironically . . . lessened the hearing's impact" on the agency's final decision. In policy cases the real decision is now made after the hearing, when the case is on appeal to agency heads. The APA allows agency heads to reverse decisions of hearing examiners, because agency heads are responsible for policy. Although barred by separation-of-functions requirements from contact with the trial staff, agency heads can use other staff members, and frequently do, to write decisions. These often reflect little or no consideration of the hearing examiner's recommendations—almost as if there had been no hearing.

Pederson shows that the APA procedural rules undermined the act's own flexibility in nonaccusatory cases by requiring that probing for facts take the form of a trial-like hearing in all cases. Separation-of-functions requirements were institutionalized in a number of agencies, and the hearing examiner evolved into an administrative law judge who is increasingly set apart from his agency.

During the last ten years, alternatives to trial-like hearings have developed that do away with the need for accusatory proceedings, administrative law judges, and separation of functions. According to Pederson, these alternatives include a greater use of rulemaking and such substitutes for separation of functions as openness and judicial review. Supreme Court opinions have affirmed certain of these procedures and encouraged others. In *Vermont Yankee Nuclear Power Corporation* v. *Natural Resources Defense Council, Inc.* (1976), the Court, while warning judges against requiring processes not imposed by the APA or statutes, approved of a searching examination of the administrative record. In *Weinberger* v. *Hynson et al.* (1973) the Court approved the increased use of rulemaking, subject to precise legal standards and in the absence of disputed facts.

Yet the decline in separation of functions and in the role of the hearing officer has gone largely unnoticed by courts and commentators, according to Pederson—for three reasons. First, the new nonadjudicatory procedures are a great improvement: they increase efficiency, shorten decision time, and allow parties to address those responsible for an agency decision

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in a relevant proceeding. Second, separation of functions has never fulfilled its advocates' expectations. Third, some of the alternatives (openness and judicial review, for example) serve the same purpose at lower cost.

Nevertheless, Pederson fears, based on the evidence of recent decisions (for example, the *Seabrook* case in 1978) and American Bar Association–sponsored bills, that the courts or Congress might extend formal adjudicatory procedures to even more nonaccusatory situations. He cautions against this and urges instead the adoption of a bill authorizing the use of "hybrid" procedures in nonaccusatory cases that could eliminate separation-of-functions requirements entirely.

Competing Theories of Regulation

"The Effects of Price Regulation in the Automobile Insurance Industry" by Richard A. Ippolito, in *The Journal of Law and Economics*, vol. 22 (April 1979), pp. 55-89.

Whether federal antitrust laws should prevent forms of state regulation is a question that currently arouses much interest. (See *Regulation*, May/June 1978, pp. 51-52.) This article is a case study of state price regulation of the automobile insurance industry. In it, Richard Ippolito of the Civil Aeronautics Board pursues inquiries suggested by the following statement: If George Stigler is correct that "as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit," federal antitrust policy ought to "offset the noncompetitive effects caused by regulation." The author asks (1) whether empirical evidence supports the Stigler thesis and (2) if not, how regulation affects the auto insurance industry.

Antitrust immunity is provided for the auto insurance industry under the *Parker* v. *Brown* doctrine (anticompetitive activities produced by state regulation are exempt from federal antitrust laws) and the McCarran-Ferguson Act of 1945 (antitrust law applies to insurance only in states that do not regulate the insurance industry). The author shows that although the automobile insurance industry is compatible with competition, forty-nine states regulated prices up until 1966, and thirty-three still do. Prices are set by the Insurance Rating Organization (ISO) and the burden of proof is on firms that want to deviate from these rates. Ippolito compares the effects of state price regulation with the situation in those states having open competition laws—that is, no prior approval for rates or categories. If insurance firms use price regulation to "collude on a competitive price," prices should be higher and less widely dispersed in a regulated state than in competitive market states. Ippolito's calculations show that regulation actually promotes more rather than less dispersed prices and that the effect of regulation tends to be neutral on the level of prices. Both results disagree with Stigler's theory of regulation. However, these results are not sufficient to disprove the theory, and the author goes on to examine whether regulation lowers costs of operation and to consider the effect of regulatory lag.

Ippolito argues that regulation does "not increase the market power of producers" and, therefore, that Stigler's theory is not supported by the results of Ippolito's study. What then does regulation do? His answer is that it affects the distribution of profits and prices for certain groups—both consumers and producers—and that it affects the short-run level of prices. The work of Paul Joskow suggests that insurance regulation reduces the growth rate of direct writer firms because it discourages the more efficient and innovative firms from either reducing prices or creating more homogeneous driver categories. Ippolito's calculations support this finding for more efficient firms generally (direct writer firms in particular), which apparently are prevented from setting prices that are consistent with their lower costs of operation (larger firms turn out to be more efficient in the insurance industry).

All firms in the industry gain economically to some extent as a consequence of regulation. The data suggest that in the absence of regulation, large firms and direct writers would compete but that regulation thwarts this competition and instead produces higher profits at least for a period of time. Small firms benefit also. Without regulation, direct writer firms would increase their market share at the expense of the smaller, less efficient firms.

Groups of consumers are affected in different ways by state regulation. For example, high-risk insured persons are subsidized through assigned risk plans and pay less than

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they would in the open market. The author's second conclusion about regulation—that it affects the short-run level of prices (regulated prices are higher or lower than the competitive norm)—is demonstrated in a case study of Government Employees Insurance Company, where state regulation was shown to endanger that firm's solvency.

Ippolito concludes by observing that there is no basis for an antitrust initiative to eliminate the McCarran-Ferguson Act and so remove the states' freedom to choose whether or not to regulate. Nevertheless, regulation appears to hinder competition among more efficient firms, produce higher profits in the short run, and prolong the existence of less efficient firms. The author's findings are consistent with the regulatory theory of Sam Peltzman—that the regulator "maximizes his political support." Ippolito suggests that a weaker federal role, leaving deregulation to the states, is called for.

Pros and Cons of Regulating

Regulation, Economics and the Law, edited by Bernard H. Siegan (Lexington, Mass.: Lexington Books, 1979), 117 pp.

In his preface, Bernard Siegan of the University of San Diego Law School explains that five of the six discussions in this monograph consider the question, Will the private market better provide for the wants, desires, needs and aspirations of the people in the presence or absence of regulation?

In the first discussion—on the question, Should there be greater government regulation of our energy future?—former Secretary of the Interior Stewart Udall and M. Bruce Johnson of the University of Miami Law School discuss the production and distribution of petroleum products. While admitting that government has some responsibility for our current predicament of importing too much oil at too great a cost, Udall rejects immediate decontrol of petroleum because of political realities. No consumer-minded congressman could defend the massive transfer of wealth from consumers to producers, he argues. Johnson disagrees and urges that resources be allowed to "flow to their highest-valued uses" in open markets, with compensation paid to those hurt most by rising prices.

In a paper on private corporations and social responsibility, Louis B. Lundborg, a former corporate board chairman, contends that the current concern for corporate social responsibility is not a fad and deserves serious support. Henry G. Manne of the University of Miami Law School counters that there is no corporate entity—only shareholders and employees and customers; and consequently, there cannot be corporate concerns that do not reflect their interests.

Arguing the affirmative on the question, Should the Federal Communications Commission be abolished?, Ronald H. Coase of the University of Chicago Law School recommends that the government "sell the rights to use the various parts of the radio frequency spectrum to the highest bidder and thus eliminate the FCC"—which he regards as a vast giveaway. Former FCC commissioner and critic Nicholas Johnson argues, in contrast, that the solution lies in improving the agency, because his experience has shown that the private sector is anything but "free enterprise oriented." He favors making access to the airwaves available to all.

Alan B. Morrison, director of Ralph Nader's litigation group, debates economist and attorney Arthur A. Shenfield on government regulation and the consumer. Morrison favors deregulation for economic activity (for example, airlines) but not for health and safety. Shenfield, pointing to Britain's disastrous regulatory policies and criticizing some of the agencies (FDA, OSHA, and CPSC) that Morrison considers necessary, denies that regulation is more effective or necessary in the health and safety area than in any other.

Governor Richard Lamm of Colorado and Bernard Siegan discuss land use regulation at state and federal levels. Lamm argues that 90 percent of land use decisions are essentially local, the remainder requiring state or regional action to protect wider interests. He accepts the principle of federal intervention only when "the state has abdicated its responsibility." In contrast, Siegan urges deregulation at all levels. He describes the history of zoning and other regulation to show its record of abuses and argues that office holders regulating land use at any governmental level will respond to public pressures and political influences, thus creating waste and inefficiency.

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The concept of national health insurance as embodied in the Kennedy-Corman bill is debated by Dr. Lester Breslow of the School of Public Health, University of California at Los Angeles, and Harry Schwartz of *The New York Times*. Breslow favors national health insurance as the only means to cure what he considers U.S. medicine's major failures: "inequity, highly variable quality, waste and spiraling costs." Schwartz contends that the bill would provide "national rationing" of health care at inflated prices and would be far less satisfactory than the present system with which most patients are content.

In the concluding chapter, Milton Friedman examines the economics of free speech, elaborating on the supposed dualism of speech rights and economic rights. He denies that these two rights are either separable or entitled to different social priorities. He insists that the social objective of maintaining a free society is so important that neither freedom should be disturbed in the absence of the strongest justification.

Reforming U.S. Energy Policy

Energy in America's Future, Sam H. Schurr, Project Director; Joel Darmstadter, Harry Perry, William Ramsay, and Milton Russell (Washington, D.C.: Resources for the Future, 1979), 555 pp.

This report of the Resources for the Future National Energy Strategies Project examines alternative energy futures. The concluding section on U.S. energy policy (chapters 15–20), written largely by Milton Russell, concentrates on the issues of energy pricing and U.S. dependence on foreign supplies. Full support is given to a pricing system that accurately reflects the value of energy to consumers and, at the same time, fully informs consumers about the true cost of energy to society. In the authors' view, controls should be removed from the prices of domestic petroleum and natural gas in order to bring these prices into line with marginal costs.

The major consequences of policies that do not reflect marginal costs are that more energy is consumed, less is produced domestically, more is imported, and both consumption and production are inefficiently allocated. The authors point out that, in simple terms, the "amount of goods and services an economy can provide is maximized when the price of each commodity or service is equal to the marginal cost of acquiring it." In the case of energy, government controls keep the price below this level. But this apparent low price is actually accompanied by hidden costs resulting from lessened productivity, deterioration in the conditions of international trade, and greater vulnerability to future energy shocks.

The study advocates a three-pronged program of energy price reform, practical difficulties notwithstanding. First, all price controls should be removed at the production stage, but this should be done gradually, since otherwise prices would rise too rapidly. Second, the price of energy should include the costs of supply uncertainty, dependence on imports, and damage to the environment, health, and safety. Third, each consumer ought to pay a price that reflects full marginal costs at the point of consumption.

This program of pricing reform would be accompanied, in the authors' view, by three problems: increased inflation, temporary economic dislocations, and changes in income distribution—particularly affecting the poor. They predict that a "permanent increase in the overall price level" would probably result from energy pricing reform, but that this effect could be offset by actions in other areas, such as government regulation and energy subsidies. The temporary dislocations should be cushioned for a specific period by policies that include special relief, which, although not economically efficient, would help achieve political acceptance of reforms.

Windfalls would be another political problem. Changes in energy pricing will produce higher incomes for some, apparently at the expense of others. Attempts to remove windfalls either through taxation or price controls would wastefully distort the economy. The authors suggest that the existing progressive tax system already "dampens the gains" of those most advantaged and that to add windfall taxes would harm the economy in the long run.

Turning to the profound effect of energy production and consumption on the environment, the authors advocate reform of environmental, health, and safety regulation so as to lessen the conflict between these concerns and

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energy goals. They emphasize the need to (1) resolve confusion over goals of environmental policy, (2) reform procedures that permit unnecessary delay and uncertainty, (3) use more efficient (and perhaps less costly) regulatory means—for example, economic incentives to control emissions, and (4) bring about administrative reforms that will make it possible to achieve clearer understanding of tradeoffs and of necessary compromises between pro-energy and pro-environmental advocates.

Russell and his fellow authors urge an end to the uncertainties of government energy policies, which confuse producers and consumers alike and deprive private decision makers of a basis for planning. The use of marginal cost pricing is the starting point. But, given the history of "interference with efficient energy pricing to achieve nonenergy goals," the public will not initially trust the change to marginal cost pricing, and the burden of the past will disappear very slowly. The "best hope," however, is to "begin as soon as possible."

Approaches to Regulatory Reform

Regulatory Reform Seminar: Proceedings and Background Papers, U.S. Department of Commerce (Office of the Secretary, October 17, 1978), 537 pp.

This volume contains a discussion of current regulatory issues by participants from government, business, public interest research organizations, and academia—plus four background papers. The purpose of the seminar was to canvass views on the broad subject of regulatory reform and to identify areas for additional research.

First, the participants looked at the area of costs and benefits. This discussion distinguished between cost and economic impact, raised the problem of measuring costs and benefits, and covered the pros and cons of using a cost-benefit calculus in regulatory decision making. Next, in considering the subject of managing regulatory policy, the participants focused on decentralized management—that is, management by the agency authorized to implement the congressional mandate—versus centralized oversight by a body like the Regulatory Analysis Review Group. Various views were offered on the feasibility of a "regulatory budget" as a means of achieving broader overview. Last, the participants considered the prospects for regulatory techniques that may be less disruptive in their effects and are more incentive-oriented.

The major part of the volume consists of the four background papers.

- A paper on costs and benefits by Lee Dymond, Donald Zimmerman, and Terence Davey of Synergy, Inc., reviews previous studies of the effects of regulations on the national economy and on specific industries or groups of industries.
- Richard Fullenbaum and Joseph E. Kasputys of Data Resources discuss in depth the conceptual framework, structure, and informational requirements of a regulatory budget and its relationship to the budget process.
- A paper by Energy and Environmental Analysis, Inc., discusses a number of alternative approaches to regulation, including various forms of direct regulation, incentive or market-based approaches, and mixtures of both. Specific case studies on nitrogen dioxide control, asbestos, and automobile passenger safety illustrate these alternatives.
- A paper on the impact of regulation on industrial location by COMSAD Research Corporation deals with the potential effects of clean air requirements on industrial location and develops analytical models to examine regional effects of clean air requirements.

The volume concludes with a caution that "research on the impacts of government regulation is in its infancy," that much more work is needed, that existing studies do not lend themselves easily to comparisons, and that little systematic research has been done on the benefits of regulation.

Critique of Health Care Proposals

Health Care Cost Increases by Jack A. Meyer (Washington, D.C.: American Enterprise Institute, 1979), 43 pp.

President Carter's proposed hospital cost containment legislation and his national health plan (NHP) fail to address the fundamental forces driving health cost increases, according to Jack A. Meyer of the American Enterprise

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Institute. Meyer suggests that these two proposals, the centerpieces of the administration's health policy, would "plunge the government deep into the health care field without promising any lasting progress in the struggle against rising costs." In the debate over these and other proposals, those who favor more regulation emphasize "market failure" in health care markets and the inability of self-correction, while those who oppose regulation point to "regulatory failure" in these markets and argue that excesses can be corrected.

Health cost increases are fueled by a system of financial incentives embodied in U.S. tax laws and wage incentives affecting (1) the purchases of insurance, (2) the use of health services, and (3) the reimbursement of providers. Existing incentives have led to increased resource intensity (more hospital workers, more equipment, more tests for a given patient load), which is widely believed to involve considerable waste and inefficiency. Because hospital cost containment proposals ignore the need to alter the incentives leading to redundant tests and equipment, excess hospital beds, and so on, such attempts to clamp a lid on cost increases are likely to be futile if not counterproductive. Meyer argues that, in the quest for quick results, this approach is likely to leave the waste unchecked and lead to undesirable cutbacks in the quality of care.

Similarly, the NHP would increase the demand for health care by making insurance coverage more widely available and more comprehensive. It would gloss over structural changes needed to eliminate wasteful spending and rely instead on a system of controls on health care providers to contain cost increases. While not passing judgment on the goal of a minimum level of insurance for all Americans, Meyer warns that combining an expansion of insurance coverage with restraints on supply (through pressure on doctors or hospitals) will feed the upward spiral of costs.

The author explains the relationship between the growth and nature of health insurance and health care cost escalation and then outlines several market-oriented approaches to arresting cost increases. These approaches include (1) greater cost-sharing to create an incentive to economize in the purchase of health care; (2) elimination of open-ended tax subsidies or their conversion to tax credits that provide a fixed amount to consumers regardless of how expensive or generous their health plan might be; (3) creation of incentives for consumers to shop around among a variety of insurance plans; (4) substitution of private

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sector for government involvement in the decisions of providers regarding the amount and quality of services produced; and (5) greater antitrust enforcement.

Meyer reviews two studies of the effectiveness of one type of government health care regulation—controls on capital expenditures by hospitals. Both studies concluded that the hospital regulations were not achieving their intended effects. Typically, attempts to limit the growth of hospital beds were either unsuccessful or accompanied by compensatory increases in spending for equipment or labor.

In the light of this explanation of rising costs and the growing evidence that the regulation of providers has not been able to moderate these costs, Meyer questions how "the flood of cost escalation can be dammed by a system of revenue or expense controls that leaves unchanged both the financial incentives and the values and appetites from which they derive." In his view, an approach that emphasizes consumer cost sharing and a more competitive environment for the purchase of insurance plans holds more promise for lasting progress. With the proper incentives in place, waste would be reduced; and any further growth in the share of GNP invested in health care could be presumed to reflect consumer preferences.

A New Look at Utility Regulation

Problems in Public Utility Economics and Regulation, edited by Michael A. Crew (Lexington, Mass.: Lexington Books, 1979), 177 pp.

In an introduction, Michael Crew of Rutgers University and Paul Kleindorfer of the University of Pennsylvania survey the theory of peak-load pricing (charging higher rates during periods of heaviest demand), indicate some of its extensions by public utilities, and give their views on the major problems of its application. They also discuss relevant theoretical issues—including the relationship of peak loads to energy conservation on the one hand and to regulation on the other—and highlight some current developments in research. One significant trend noted is a more intensive consideration of the effect of regulation on efficiency. This concern with efficiency has led to a broader and more critical view not only of the nature of efficiency but also of the regulatory process.

The new approach goes beyond the traditional approach, which relates marginal cost to price, and considers the internal efficiency of organizations, the costs of enforcing compliance, and an entirely new theory of market and hierarchical failure. Current research in regulation focuses on economies-of-scale and thus deals with natural monopoly in a much more fundamental way than did previous research. All of these considerations are illustrated in the eight papers collected here from two seminars held at Rutgers University in 1978. The papers cover regulation, applications of peak-load pricing, and peak loads and regulation.

Elizabeth Bailey of the Civil Aeronautics Board examines some of the recent reforms in the CAB's regulatory process, especially the deregulation that has taken place during her term. Enrique Arzac and Frank Edwards of Columbia University propose a conceptual framework for analyzing some effects of regulation on internal efficiency in regulated and unregulated firms. Fred Sudit of Rutgers University proposes an alternative to the current system of regulation which would provide incentives for productivity through automatic rate adjustments.

John Wenders of the University of Arizona and R. Ashley Lyman of the University of Idaho discuss applications of peak-load pricing to electric utilities, giving actual examples of time-of-day rates and their net benefits. Colin Blaydon, Wesley A. Magat, and Celia Thomas of Duke University use two models to project marginal cost prices for natural gas.

The last chapters deal with peak loads and regulation. Roger Sherman of the University of Virginia and Michael Visscher of Ohio State University consider the effect of rate-of-return regulation (ratesetting up to a maximum percentage of return on capital) on various monopoly-pricing policies. Gerald Faulhaber of American Telephone Company examines some of the effects of the Federal Communications Commission's accounting rules for allocating capacity cost on long-distance telephone rates and the implications of the divergence of these rates from efficient peak-load prices. Finally, Michael Crew and Paul Kleindorfer examine problems of rationing that occur when demand exceeds capacity and some effects of regulation on reliability planning by public utilities.

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(Letters continued from page 4)
scratch the surface of the non–cost impact issue.

Also, we need to remember that refining our ability to assess regulatory costs and benefits is only part of what must be done to bring order and balance to the regulatory system. In this regard, a number of important measures have recently been taken to improve regulatory management—for example, establishment of the Regulatory Council and the Regulatory Analysis Review Group, development of the Regulatory Calendar, the proposing of the Regulation Reform Act, and the Commerce Department's own work on a regulatory budget. While the government has always been mindful of the problems regulation is intended to solve, it has now become a great deal more sensitive to the problems that regulation creates.

Lucy Falcone, Acting Assistant Secretary for Policy, Department of Commerce

TO THE EDITOR:

In our 1979 annual report on the economy, the Joint Economic Committee of the Congress made two important recommendations for cutting the waste and inefficiency out of federal regulatory programs.

First, it should be required that all major government regulations be cost-effective. As amazing as it may seem, the laws that created our various regulatory programs seldom require that costs be examined, and there are even instances where the law actually prohibits any consideration of costs when regulations are being developed. . . . Second, the federal government should adopt a regulatory budget—not right away, but in the future as the technical problems of this device are resolved. Whereas the budget used to give a fair picture of government's impact on the economy, this is no longer true: regulation now is a major way in which the government commands private resources for public purposes outside the budget. . . .

Both of these recommendations—which were unanimously endorsed by the committee's Democratic and Republican members—would work to cut the unnecessary and wasteful costs that we find today in many regulatory programs. . . .

The Business Roundtable's "Cost of Government Regulation" study has contributed to a heightened interest in cost-effectiveness by defusing an important concern of those who oppose our attempts to control excessive regulatory costs—the concern that regulatory costs cannot be measured accurately enough to make informed choices among alternatives or to be included in a regulatory budget.

Of the four types of regulatory costs identified by Dr. Marvin Kosters in "Counting the Costs" in your July/August issue—administrative, compliance, transfer, and inefficiency—the only ones we could readily measure until recently were the administrative costs, which appeared in the federal budget. The others were elusive. The Business Roundtable study has helped change that by improving our ability to measure compliance costs. . . . Building on the work of that study and others, I believe we can develop a reasonable methodology for measuring compliance costs accurately enough for cost-effectiveness and regulatory budget uses, and I think Congress and the administration should get to work on this as soon as possible.

The fact remains that we cannot and probably will never be able to measure transfer and inefficiency costs. Nevertheless, we should not let this be used as a smokescreen to block meaningful regulatory reform. Virtually all federal government programs—and not just regulatory programs—involve transfer and inefficiency costs that are often large and unmeasurable. Yet we have never hesitated to undertake a necessary government program simply because we couldn't measure its indirect effect on the economy's efficiency or the distribution of income. . . .

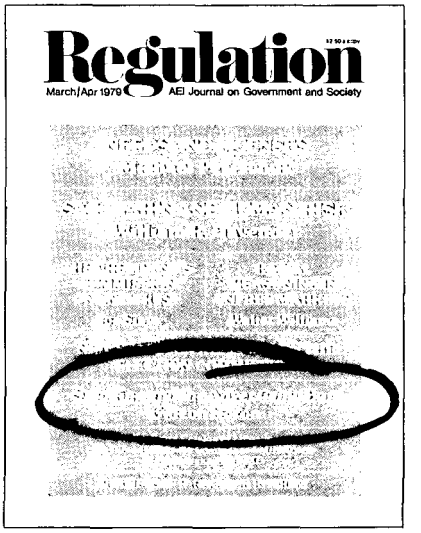
We should get on with the job of developing the fairly straightforward techniques needed for measuring compliance costs in order to ensure timely implementation of a cost-effectiveness requirement and, eventually, a regulatory budget, and not wait for what Dr. Kosters calls the "more complex and sophisticated methods of economic analysis" needed for measuring transfer and inefficiency costs. Further delay will mean more and more wasteful and inefficient regulations, higher costs, and, ultimately, more inflation.

Lloyd Bentsen, Chairman, Joint Economic Committee of the United States Senate

More on Cigarette Advertising

GIDEON DORON responds:

Since I am currently in Israel where smoking is not regulated but postal services are, I received your invitation to respond to the Tobacco Institute's letter on my article far too late to make the deadline. [See Doron's "How Smoking Increased When TV Advertising Was Banned," *Regulation*, March/April 1979, and letter to the editor from William Kloepfer, Jr., July/August.] The points raised in that letter are interesting.



It is true that during the heyday of the antismoking commercials, 1968–1970, the declining trend for cigarette consumption was not uniform. But the results of my statistical research (see *The Smoking Paradox*, Abt Books, 1979) show clearly that the antismoking commercials were the cause of the reduction in the level of consumption during these years. While the commercials lost some of their potency by 1970 (when industry sales did go up), they still had a detrimental effect on *per capita* cigarette consumption in that year. It seems to me that per capita consumption, not total industry sales, is the proper measure for the policy maker to use in this case.

It is also true that there were some cigarette price increases in the relevant years. But my tests show clearly that the Fairness Doctrine, a single factor, was the most influential in cutting the margins of the smoking population. It was not price increases, although they do affect consumption negatively, even in the cigarette market. Again, the antismoking commercials gave the regulator his biggest "bang" for a "buck."

Third, Mr. Kloepfer's point regarding the relevant age group to

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be used in calculating cigarette consumption—fourteen years and over, as I suggested, or eighteen years and over, as employed by "conventional measurements"—is insignificant. I conducted tests on both age groups, employing data gathered by the U.S. government and the industry itself, and found virtually no differences in their aggregate patterns of consumption over time. The correlation coefficient between the two groups consistently stands at 0.98. I also think that, regardless of one's interest or position, there is no reason to doubt the integrity of the American Cancer Society surveyors.

Finally, Mr. Kloepfer's main objection appears to be to the last line of my article: "One finds a certain sympathy for the FTC." He apparently missed the sarcasm in that line. I do not think that the FTC has the responsibility to bring about a reduction in cigarette consumption. I do believe in "freedom of choice" and, preferably, informed choice.

Vouchers and Government Control

TO THE EDITOR:

Peter Skerry's book review of *Education by Choice: The Case for Family Control* by John E. Coons and Stephen D. Sugarman correctly points out that educational vouchers might not ease the burden of regulation on schools (*Regulation*, July/August 1979). I am convinced that any sort of voucher system that is at all likely to be implemented will greatly increase the degree of government control and enforced uniformity—all in the name of "free choice." The very premise of the voucher scheme is that education is solely the responsibility of the state, which exacts the necessary funds through taxation and then doles out vouchers to parents.

If free choice in education is desirable not only as an ideal but also as a workable improvement on the present system—and libertarians would argue that it is—then the only way to accomplish this is through direct *tax credits* for education. Not only parents, but also anyone else who spent money to educate a child, should be allowed to deduct a substantial portion of the cost of that education from their tax obligations.

Education tax credits would, with one sweep, put government and non-government schools on an equal footing, and would also stimulate innovation, maximize free choice, encourage private aid to families who might not otherwise be able to afford alternative schooling, and restrict government's ability to impose regulations on education. Equally important, tax credits rest on the premise that the money belongs to the individual, not the government, and that education is properly the responsibility of the individual.

Chris Hocker,
National Director,
Libertarian Party

PETER SKERRY responds:

I am pleased that Chris Hocker agrees with my assessment of Coons and Sugarman, but I feel compelled to disagree with him strongly on particulars. First, I do not share his optimism that tuition tax credits represent a realistic alternative to vouchers as a means of avoiding government regulation. Certainly, the Supreme Court's recent decision in *Byrne* v. *Public Funds for Public Schools*, in which a New Jersey tuition tax program was ruled unconstitutional, offers little basis for hope. And it would seem that Mr. Hocker's argument for tuition tax credits has already been seriously undermined by their most prominent proponent, Senator Daniel P. Moynihan (Democrat-New York), who has argued that tax credits do indeed represent state aid and that, contrary to prevailing interpretations of the First Amendment, religious schools are constitutionally eligible to receive it.

As I emphasized at the end of my review, I believe that vouchers "remain an attractive alternative to the present system." Unlike Mr. Hocker I am not convinced that vouchers will necessarily lead to increased governmental control of schools, though this is a real possibility. And certainly more of the same would be bad enough. I do think those concerned to promote choice and diversity in education must assume that either of the schemes mentioned—vouchers or tuition tax credits—will lead to demand for public accountability for what will be considered public funds. The next step then, which I attempted to take in my review, is to weigh these kinds of disadvantages of the specific proposals being made against the much more frequently discussed advantages of those proposals. ■

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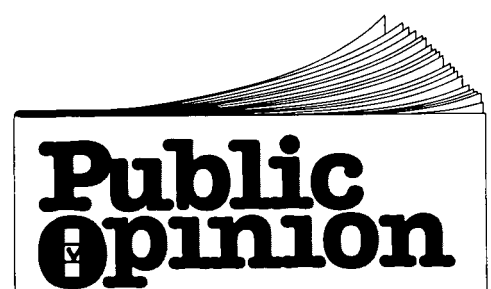

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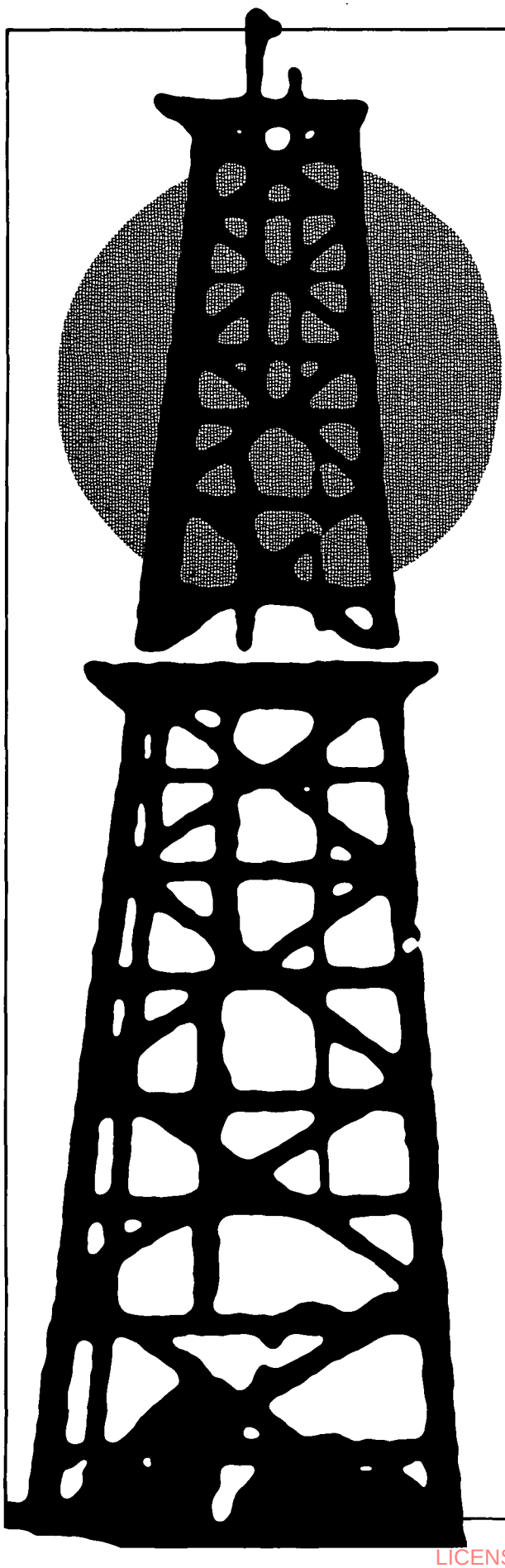

Petroleum Price Regulation: Should We Decontrol?

By:

Kenneth J. Arrow, Joan Kenney Professor of Economics at Stanford University and winner of the 1972 Nobel Prize in Economic Science,
and
Joseph P. Kalt, instructor of economics at Harvard University and former staff member of the President's Council of Economic Advisers.

According to Arrow and Kalt, "oil price regulations in fact impose a net efficiency loss on the U.S. economy. Consequently, the crucial question is whether the gains in efficiency from decontrol outweigh any equity losses." The answer: decontrol would have the beneficial effect of increasing the size of the aggregate U.S. economic "pie"—but not all groups would benefit from decontrol, say the authors. Domestic crude-oil producers would be gainers, while domestic crude-oil refiners and, to a somewhat lesser extent, domestic petroleum consumers would be losers. With or without a windfall-profits tax to compensate for this consumer-to-producer income transfer, however, decontrol is preferable to continued price regulation.

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